# THE EU REGULATION OF THE GAS MARKET: IS A NEW APPROACH EMERGING?

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A thesis submitted to the University of Birmingham

for the degree of DOCTOR OF PHILOSOPHY

College of Arts and Law

University of Birmingham

April 2018

# *Abstract*

This thesis explores the international and national legal tools binding the EU and Russia in the energy field and how they impact on the EU-Russia geopolitical relationship. This work will focus on natural gas regulation, given the rising importance of this energy source on the global scale. The approach used starts from legal analysis and is constantly enriched by taking into account economic, political and practical considerations.

From the international law perspective, we argue that the rules of World Trade Organization ('WTO') represent the only workable legal framework in the instant case. Internally, we identified the Lisbon Treaty as a turning point of European energy regulation. Pre-Lisbon gas legislation could be problematic when assessed under WTO rules and its application showed a lack of coherence with external EU energy relations. By contrast, we found that the Lisbon Treaty and the ensuing legislation are likely to empower the EU with the adequate tools to overcome the pre-Lisbon problems and build solid bilateral relations with Russia. This could be a major improvement to secure EU natural gas supply since economic data show that Russia is likely to remain the most important EU gas supplier in the next 25 years.

*To Mom and Dad*

# *Table of Contents*

# *List of Illustrations*

# *List of Tables*

# *Table of Cases*

## WTO Appellate Body Reports

*United States – Countervailing and Anti-Dumping Measures on Certain Products from China – Report of the Appellate Body* (7 July 2014) WT/DS449/AB/R

*United States – Countervailing Duty Measures on Certain Products from China – Report of the Appellate Body* (18 December 2014) WT/DS437/AB/R

*United States – Import Prohibition of Certain Shrimp and Shrimp Products – Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R

*United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services – Report of the Appellate Body* (7 April 2005) WT/DS285/AB/R

*United States – Measures Affecting the Production and Sale of Clove Cigarettes – Report of the Appellate Body* (4 April 2012) WT/DS406/AB/R

*United States – Standards for Reformulated and Conventional Gasoline – Report of the Appellate Body* (29 April 1996) WT/DS2/AB/R

*United States – Tax Treatment for 'Foreign Sales Corporations' – Report of the Appellate Body* (14 January 2002) WT/DS108/AB/R

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*Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather – Report of the Panel* (19 December 2000) WT/DS155/R

*Argentina – Measures Affecting the Importation of Goods – Report of the Panel* (22 August 2014) WT/DS438/R

*Argentina — Measures Relating to Trade in Goods and Services – Report of the Panel* (9 May 2016) WT/DS453/R

*Brazil – Measures Affecting Imports of Re-treaded Tyres – Report of the Panel* (12 June 2007) WT/DS332/R

*Canada – Certain Measures Affecting the Automotive Industry – Report of the Panel* (11 February 2000) WT/DS139/R

*Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain – Report of the Panel* (6 April 2004) WT/DS276/R

*China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products – Report of the Panel* (12 August 2009) WT/DS363/R

*China – Electronic Payment Services – Report of the Panel* (16 July 2012) WT/DS413/R

*Colombia – Indicative Prices and Restrictions on Ports of Entry – Report of the Panel* (27 April 2009) WT/DS366/R

**GATT Panel Reports**

*Japan – Restrictions on Imports of Certain Agricultural Products – Report of the Panel* (2 March 1988) BISD 35S/163

*Japan – Trade in Semi-Conductors – Report of the Panel* (24 May 1988) BISD 35S/116

*Japanese Measures on Imports of Leather – Report of the Panel* (15 May 1984) BISD 31S/94

*Spain – Tariff Treatment on Unroasted Coffee – Report of the Panel* (11 June 1981) BISD 28S/102

*United States – Manufacturing Clause – Report of the Panel* (15 May 1984) BISD 31S/74

*United States – Measures Affecting Alcoholic and Malt Beverages – Report of the Panel* (19 June 1992) BISD 39S/206

*United States - Restrictions on Imports of Sugar United – Report of the Panel* (22 June 1989) BISD 36S/331

*United States – Trade Measures Affecting Nicaragua – Report of the Panel* (13 October 1986) L/6053

**European Cases**

Case C-22/70 *Commission v Council* [1971] ECR 263

Case C-72/83 *Campus Oil and Others v Minister for Industry and Energy* [1983] ECR I-2727

Joined Cases C-241/91 and C-242/91 *Magill v Commission* [1995] ECR I-743

Case T-41/96 *Bayer AG v Commission* [2000] ECR II3383

Case C-58/99 *Commission of the European Communities v Italian Republic* [2000] ECR I-3811

Case C-379/98 *Preussen Elektra v Schleswag* [2001] ECR I-2099

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Case C-206/06 *Essent Netwerk Noord and Others* [2008] ECR I-5497

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European Parliament and European Council Directive 2003/55/EC of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L176

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European Parliament and European Council Decision 994/2012/EU of 25 October 2012 establishing an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy [2013] OJ L299/13

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—— 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of Regions, and the European Investment Bank: A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy' COM (2015) 080 final

—— 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: On an EU Strategy for Liquefied Natural Gas and Gas Storage' COM (2016) 49 final

—— 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: An Eu Strategy on Heating and Cooling' COM (2016) 51 final

—— 'Impact Assessment: On Establishing an Information Exchange Mechanism with Regard to Intergovernmental Agreements and Non-Binding Instruments between Member States and Third Countries in the Field of Energy Repealing Decision No 994/2012/EU' COM (2016) 53 final

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# *List of Abbreviations*

| | |
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| **ACER** | Agency for the Cooperation of the Energy Regulators |
| **BIT** | Bilateral Investment Treaty |
| **CCP** | Common Commercial Policy |
| **CETA** | Comprehensive Economic and Trade Agreement |
| **CJEU** | Court of Justice of the European Union |
| **DG Competition** | Directorate General for Competition of the European Commission |
| **DSB** | Dispute Settlement Body |
| **EC** | European Commission |
| **ECT** | Energy Charter Treaty |
| **EU** | European Union |
| **FDI** | Foreign Direct Investment |
| **Gas Directive** | European Parliament and Council Directive 2009/73/EC of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ 49/112L |
| **GATS** | General Agreement on Trade in Services |
| **GATT** | General Agreement on Tariffs and Trade |
| **Gazprom** | OAO Gazprom and its subsidiaries taken as a whole |
| **ICJ** | International Court of Justice |
| **ICSID** | International Centre for Settlement of Investment Disputes |
| **IEA** | International Energy Agency |
| **IGA** | Intergovernmental Agreement |
| **Lisbon Treaty** | Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community [2007] OJ C306/07 |
| **LNG** | Liquefied Natural Gas |
| **MS** | Member State |
| **NRA** | National Regulatory Authority |
| **OECD** | Organisation for Economic Co-operation and Development |
| **PCA** | Partnership and Cooperation Agreement |
| **TEU** | Consolidated Version of the Treaty on European Union [2008] OJ C115/13 |
| **TFEU** | Consolidated Version of the Treaty on the Functioning of the European Union [2008] OJ C 115/47 |
| **TPA** | Third Party Access |
| **TSO** | Transmission System Operator |
| **TTIP** | Transatlantic Trade and Investment Partnership |
| **WTO** | World Trade Organization |

# INTRODUCTION

**Summary:** 1. Premise – 2. The Importance of a Secured Energy Supply – 3. Geopolitics and Energy – 4. Energy Dependence and the International Economic Order – 5. Defining Features of the Energy Market – 6. Natural Gas and the EU – 7. Applicable Legal Framework – 8. Research Questions and Hypothesis – 9. Methodology and Structure.

## 1. Premise

This PhD thesis is about the impact of international and EU regulations on EU-Russia energy relations. With this aim, it analyses the compliance of the most important EU measure regulating the internal natural gas market with the applicable international rules binding the EU in the field.

This chapter lays down the conceptual framework of the thesis. It sets out the main concepts and trends covering a wide range of fields connected to energy (international relations, economics, law etc.), which are key elements to facilitate the reading of the following chapters of the thesis.

We will start off from the description of the energy sector and of its most important features and concepts. Then, we will sketch out the main characteristics of the natural gas field and will explain the reasons justifying its importance in the current world-wide energy scenario. Lastly, we will focus on the EU-Russia relationship and pose some questions, which will be answered in the following chapters of the thesis.

Reference to the conceptual framework will be made, when appropriate, in the following chapters of this work.

## 2. The Importance of a Secured Energy Supply

From the beginning of mankind, access to energy sources has largely determined the difference of peoples' living conditions. The most powerful countries have always been those that were able to benefit from huge natural resources, or to durably purchase them from their commercial partners. This is particularly true today, since modern societies massively need energy sources to fuel their economies. The importance of energy supply in today's world is undisputable. Can you imagine living one single day without electricity, with no lights, computers, TVs and mobile phones, but also no transportation systems such as trains or metro lines? Perhaps for some this could even be a welcome escape from routine. However, this condition would not probably last long. In any country where energy disruptions happened, unexpected blackouts would immediately disrupt the industrial production system and the delivery of public services, causing serious damage to the conditions of everyone living in that region.[1]

The guarantee of personal and collective security of the citizens is one of the very first prerogatives of nation states. This holds true especially in the case of energy matters, because of the strategic importance of the security of the energy supply for the citizens' welfare and for industrial production.

[1] In Case C-72/83 *Campus Oil and Others v Minister for Industry and Energy* [1983] ECR 2727, para 34, the Court of Justice of the European Communities (now Court of Justice of the European Union) admitted that 'petroleum products, because of their exceptional importance as an energy source in the modern economy, are of fundamental importance for a country's existence since not only its economy but above all its institutions, its essential public services and even the survival of its inhabitants depend upon them. An interruption of supplies of petroleum products, with the resultant dangers for the country's existence, could therefore seriously affect the public security that Article 36 allows States to protect'. More recently, US Secretary of State, 'Statement on Energy Diplomacy on 21th Century' (2012) <https://2009-2017.state.gov/e/enr/rls/202263.htm> accessed 11 November 2017, and Royal Academy of Engineering, 'Counting the Cost: The Economic and Social Costs of Electricity Shortfalls in the UK' (2014) 16 – 17 <https://www.raeng.org.uk/publications/reports/counting-the-cost> accessed 11 November 2017. The report of the Royal Academy of Engineering describes the effects of six outages in developed countries between 2001 and 2014, whose estimated damages amount to 50 billion dollars.

## 3. Geopolitics and Energy

Geopolitics is a complex and often unstructured web of interactions on a global scale and can be defined as a power struggle between people, businesses and institutions (as political actors) of different countries under geographical, economic and technological constraints.[2] Hence, any assessment of the balance of power between countries cannot be limited to an analysis of their governments' actions, but should include an analysis also of the specific businesses and the individuals involved.

Geopolitical constraints set the framework for what is possible to achieve at a particular point in time and constitute structural elements of the world system.[3] As mentioned, geopolitical constraints are geography, economics and technology. Geography limits what is possible in the natural world and reinforces custom barriers. Economics relates to the forces which determine the price formation, interest rates, inflation levels and trade barriers. Technology determines what is possible to achieve from a technical point of view. These constraints are not unchangeable, as it is possible for political actors to alter the environment in which they operate. Moreover, geopolitical constraints are often interrelated and co-dependent. For instance, a new technical discovery that overcomes a geographical constraint may lead to the formation of a new market and thereby also overcome a previous economic constraint. So, while geographic and technological constraints preclude, for the time being, the exploitation of Arctic gas reserves, new drilling techniques (technological change) and/or the melting of Arctic ice (geographical change) may make the reserves available in the future. In light of this potential new

[2] Ernst and Young, 'Navigating Geopolitics in Oil and Gas' (2015) 6 <http://www.ey.com/Publication/vwLUAssets/EY-navigating-geopolitics-in-oil-andp-gas/$FILE/EY-navigating-geopolitics-in-oil-andp-gas.pdf> accessed 11 November 2017.

[3] Ibid 9.

scenario, governments need to enter into agreements with one another and promulgate laws and regulations to govern the present and future operations of the energy companies seeking to exploit the fields.

The energy field contributes more than other sectors to shape geopolitical relations between countries because of its strategic importance for the countries concerned and the pervasive presence of the State in the economy (see below).

## 4. Energy Dependence and the International Economic Order

When a country cannot satisfy its energy demand internally, it must import to make up for the shortfall. The more energy is imported, the more the importing country is dependent upon foreign energy producers. Energy dependence is a key feature in the geopolitical relations between States. Indeed, exporting countries can exert their influence on importing countries' sovereignty by leveraging their position. This happens quite frequently. To give an example, the 'gas wars' between Ukraine and Russia were characterised by the Russian threat to cut-off the gas supply to Ukraine, leaving millions of Eastern Europeans in the cold. We shall return to the gas wars in more detail below.[4]

Compounding the effects of the natural inequality of distribution of energy resources are modern economic forces, which foster relationships of mutual dependence among countries. These economic forces draw their strength from the comparative advantage theory that underpins liberalism and international trade. According to the comparative advantage hypothesis, countries should specialise in economic activities for which they

[4] 'Gas wars' is an expression that refers to the disputes between Ukrainian oil and gas company Naftogaz and Russian gas supplier Gazprom over natural gas supplies, prices, and debts. These disputes have grown beyond simple business disputes into transnational political issues – involving political leaders from several countries – threatening natural gas supplies in numerous European countries dependent from Russian gas transported through Ukraine. See chapter I, page 18.

enjoy a comparative advantage over other countries (e.g. price, availability of resources etc.) and import everything else.[5] Overall, this is more efficient and cost effective than producing everything internally.

In case of energy, production costs determine the extent of the comparative advantage that will be enjoyed by a supplier country. The importance of energy requires that it should be sufficiently and continuously available at a reasonable price.[6] The import-export relationships created, which characterise the capitalistic worldview, strongly incentivise the creation of dependency relations between countries and shape the international economic order.

## 5. Defining Features of the Energy Market

Three features have come to define the energy market in recent decades.

The first is supranational regulation, which is an aspect and result of the progressive globalisation of the economy in general, and the increasingly interconnected nature of the energy market in particular. New transportation technologies have had a particularly powerful impact on the natural gas market. In recent years, the widespread adoption of the liquefaction technique has created new trade flows between countries that previously did not have commercial relations in this industry owing to the transportation constraints via pipeline.[7] The liquefaction technique has been combined with another innovation,

[5] For an overview of the matter, see Michael E Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (Simon and Schuster 2008); Andrea Maneschi, *Comparative Advantage in International Trade: A Historical Perspective* (EE 1998).

[6] Gonzalo Escribano and Javier Garcia-Verdugo, 'Energy Security, Energy Corridors and the Geopolitical Context: A Conceptual Approach' in Jose Maria Marin-Quemada, Javier Garcia-Verdugo and Gonzalo Escribano, *Energy Security for the EU in the 21st Century – Markets, Geopolitics and Corridors* (Routledge 2012) 27.

[7] The liquefaction technique transforms natural gas into a liquid – so-called 'liquefied natural gas' or 'LNG' – simplifying its transportation. The liquefaction technique requires huge investments, both by the producing and by the consuming States. In fact, it needs the construction of liquefaction and gasification

'fracking', which enables the exploitation of previously unavailable natural gas and oil reserves trapped in porous rock layers.[8] The development of new technologies facilitating the creation of a global energy market pushed for the adoption of regional and international energy regulation schemes, especially in areas with a high level of integration or similar economic development.[9] In the absence of all-encompassing international guidelines regulating the matter, transnational law issues emerged.[10]

The second is the contrast between the public and private interests that drive the actions of market operators. More broadly, this is a matter that touches upon the role of the State in the national economy, which often crops up as an issue whenever an industry is characterised by the presence of a natural monopoly (e.g. natural gas, electricity, telecommunications and railways).[11] Even in capitalist economies, governments often intervene directly in the energy market.[12] In some cases, even when States do not directly

terminals and the use of dedicated ships (so-called 'LNG carriers'), preserving natural gas below the gasification point. This technique increases the number of producing countries able to compete for the satisfaction of the global natural gas demand.

[8] Fracking is a slang term for hydraulic fracturing, which is the process of creating fractures in rocks and rock formations by injecting specialised fluid into cracks to force them to open further. The larger fissures allow more oil and gas to flow out of the formations and into the wellbore, from where they can be easily extracted (Source: Investopedia, 'Fracking' (2017) <http://www.investopedia.com/terms/f/fracking.asp> accessed 18 May 2017).

[9] The discussions about energy in the Transatlantic Trade and Investment Partnership (TTIP) and in the Comprehensive Economic and Trade Agreement (CETA), as well in the WTO treaty, and the intention to upgrade the Energy Charter Treaty to a global scale, evidence this trend. The application of the Energy Charter Treaty principles at a global scale is one of the objectives of the International Energy Charter. See Energy Charter Secretariat, 'International Energy Charter' (2015) <http://www.europarl.europa.eu/meetdocs/2014_2019/documents/itre/dv/energy_charter_faq_/energy_charter_faq_en.pdf> accessed 23 July 2017.

[10] Transnational law regulates actions or events that transcend national frontiers. It involves individuals, corporations, states, or other groups – not just the official relations between governments of states. This is typical of fields which could strongly impact on the geopolitics of a country.

[11] See chapter II, section 2.1.

[12] State-owned enterprises play a particularly important role in network industries. The OECD estimated that in value terms state-owned enterprises active in the energy and transport sectors count for about 40% of the total value of state-owned enterprises and about 43% of total state-owned enterprises jobs. The concentrated presence of state-owned enterprises in these sectors makes their performance extremely relevant for the determination of spill-overs to the rest of the economy. See European Commission, 'State-Owned Enterprises in the EU: Lessons Learnt and Ways Forward in a Post-Crisis Context' (2016) 1

own energy companies, specific control mechanisms have been implemented.[13] Left to their own devices, private companies will not satisfy a nation's service needs if the costs of infrastructure construction and maintenance exceed expected revenues (e.g. rural areas). In principle, this behaviour excludes important shares of the population from the energy service. This state of affairs is not acceptable from the State perspective, which wants these essential facility services to be available to all its citizens. Accordingly, wherever the sector underwent privatisation and liberalisation (notably in Europe), governments stepped in to impose universal service obligations on private-sector operators.[14]

The third is the rapid spread of renewable energy sources. Since the 1970s, renewable energy production has bloomed. The International Energy Agency reports that from 1973 to 2014 the percentage of primary energy produced from renewable sources in OECD countries went from 4.6% to 9.5%.[15] At the same time, total consumption rose by 40%.[16]

<https://ec.europa.eu/info/sites/info/files/file_import/ip031_en _2.pdf> accessed 21 June 2017. In Europe the scope of public ownership in various sectors of the economy is particularly extensive in some of the new Member States such as Poland, Croatia, Romania and Slovenia. However, state-owned enterprises prominently feature also in some EU15 Member States such as France, Italy and Sweden.

[13] One example is the so-called 'golden-share', allowing the public power to benefit from control rights through the ownership of a single share of the energy company concerned. See: Stefan Grundmann and Florian Möslein, **'**Golden Shares - State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' (2003) <http://ssrn.com/abstract=410580> accessed 1 May 2016.

[14] A 'universal service' has the following characteristics: 1) promotes the availability of quality services at just, reasonable, and affordable rates; 2) increases access to advanced telecommunications services throughout the country; 3) advances the availability of such services to all consumers, including those in low income, rural, insular, and high cost areas at rates that are reasonably comparable to those charged in urban areas. See Olga Batura, *Universal Service in WTO and EU law: Liberalisation and Social Regulation* (Springer 2016) 43; Damien Geraldin, *The Liberalisation of Electricity and Natural Gas in the European Union* (Kluwer Law International 2001) 19.

[15] International Energy Agency, 'Key World Statistics' (2015) 7 <http://www.iea.org/publications/freepublications/publication/KeyWorld_Statistics_2015.pdf> accessed 22 May 2016. The European Commission defines 'primary production of energy' as 'any extraction of energy products in a useable form from natural sources. This occurs either when natural sources are exploited (for example, in coal mines, crude oil fields, hydro power plants) or in the fabrication of biofuels'. See Eurostat, 'Glossary: Definition of Primary Production of Energy' (2017) <http://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Primary_energy_production> accessed 29 July 2017.

[16] Ibid.

For the most part, renewable energy sources are used to produce electricity, but may also be harnessed directly for thermal purposes. The success of clean energies is often due to the availability of generous subsidies to enable them to compete economically with the production costs of energy deriving from 'grey' (polluting) sources.[17] The adoption of green energy incentivising policies responds mainly to two needs: first, to combat climate change, and second, to decrease dependency on third countries by reducing imports, fostering local production.

## 6. Natural Gas and the EU

The EU is currently the largest energy importer in the world, importing 53% of the energy it consumes at an annual cost of around 400 billion euros.[18] Relationships based on trust with supplier countries are therefore essential to the well-being of European citizens. One of the most imported energy sources is natural gas, which serves as the principal back-up when power generation from renewable sources fails to meet demand.[19]

Natural gas currently amounts to 23.8% of the total energy consumed in the EU and is the only 'grey' energy source that has seen an increase in the consumption since the

[17] Green energies have been incentivised in several countries all over the world through the adoption of measures which help investors to pay back the investments made and compete with the higher production costs of renewables. Grey energy is another word for polluting energy or non-renewable energy. In generating grey energy, fossil fuels are used such as coal, oil or gas.

[18] European Commission, 'Press Release: Energy Union: Secure, Sustainable, Competitive, Affordable Energy for Every European' (2016) <http://europa.eu/rapid/press-releaseIP-15-4497en.htm> accessed 16 July 2016.

[19] See Eurostat, 'Share in Renewables of Energy Consumption in the EU' (2016) <http://ec.europa.eu/eurostat/web/energy/data/shares> accessed 16 July 2017; Elena Verdolini, Francesco Vona, David Popp, 'Bridging the Gap: Do Fast Reacting Fossil Technologies Facilitate Renewable Energy Diffusion?' (2016) National Bureau of Economic Research Working Paper 22454/2016 <http://www.nber.org/papers/w22454?utm_campaign=ntw&utm_medium=email&utm_source=ntw> last accessed 16 July 2017.

1990s, thanks also to the technological developments related to gas liquefaction.[20] Indeed, since 1990 the share of coal and lignite in EU28 primary energy consumption decreased from 28.9% to 18.2%, whereas oil dropped from 35% to 30.1%.[21] The foregoing features reflect a worldwide trend which witnesses the success of natural gas on a global scale.[22]

Since its inception, the EU has been based on a free-market ideology. According to neo-classical economic theory, perfect competition leads to allocative and productive efficiency and therefore to increases in consumer welfare.[23] While the internal (i.e. EU) gas market should essentially be governed by the rules of the free market, geopolitics can sometimes get in the way.[24] In this respect, a geopolitical risk to the security of supply arises 'when a change or breakdown in the international economic order or system or a part of that system takes place […] that results or could result in absolute or relative scarcity in energy flows'.[25] In the natural gas market, the break of the international economic order could mainly derive from economic, political and regulatory factors.[26]

[20] European Environment Agency, 'Primary Energy Consumption by Fuel' (2016) <http://www.eea.europa.eu/data-and-maps/indicators/primary-energy-consumption-by-fuel6/assessment> accessed 22 May 2016. See also chapter I, section 2.

[21] Ibid.

[22] The general conclusion of this work will analyse the future developments of the industry.

[23] Glenn Hubbard and Anthony P O'Brien, *Microeconomics* (Paerson Prentice Hall 2006) 243.

[24] This danger is common to other fields, such as the financial markets. See Gregory Dunn, 'The Rise of Economics in Contemporary Geopolitics' (2015) Harvard International Review <http://hir.harvard.edu/article/?a=8304> accessed 7 July 2016.

[25] Clingendael International Energy Programme, 'Study on Energy Supply, Security and Geopolitics: Final Report' (2004) 37 <http://www.clingendaelenergy.com/inc/upload/files/Study_on_energy_supply_security_and_geopolitics.pdf> accessed 7 July 2016.

[26] Chapter I, section 4, will analyse this topic.

## 7. Applicable Legal Framework

The way EU Members States procure natural gas has changed considerably in the last two decades, but European dependence upon third (i.e. non-EU) countries has remained constant.[27] A legal framework that binds the EU and its suppliers is fundamental to guarantee the stability and security of the energy supply of the Union. A solid legal framework requires international agreements that take all the interests of the parties involved into account, set out clear regulatory parameters, and enshrine the principles of mutual trust and recognition among the undertakings operating in the respective territories. In the absence these conditions, mutable economic forces and politically-motivated interests can easily endanger the stability of international energy relationships.

Over the years, the European regulator has dramatically modified the internal natural gas market structure and the way private undertakings – usually State-controlled entities – conduct their businesses in the Union. All of this must comply with the existing international rules binding the EU in the energy field. The compliance with international rules is especially relevant in case of high volumes traded between the parties, such as it happens with natural gas.

A turning point in the EU's energy strategy was the Lisbon Treaty. As this thesis attempts to show, this is the dividing line between two types of approach to the EU energy issues, which reflect a different competence allocation between Member States and the Union, in line with the trend towards a supranational regulation described in section 5 above. A further interventionist push has come from the current European Commission, which has

[27] For an extensive overview see Rafael Leal-Arcas, Costantino Grasso and Juan Alemany Ríos, '*Energy Security, Trade and the EU: Regional and International Perspectives* (EE 2016) 26-40; Mekdi P Amineh and Wina HJ Crijns-Graus, 'Rethinking EU Energy Security Considering Past Trends and Future Prospects' (2014) 13 Perspectives on Global Development and Technology, 767-780 <https://www.difesa.it/SMD_/CASD/IM/IASD/65sessioneordinaria/Documents/RethinkingEUEnergySec.pdf> accessed 7 July 2016.

made energy a top priority of its mandate and supported the creation of a proper 'European Energy Union'.[28]

## 8. Research Questions and Hypothesis

Considering the importance of natural gas regulation on the relationships between the EU and third countries, this thesis will try to answer to the following questions: What is the actual impact of the current international legal framework on the energy relationships between the EU and its suppliers? Are the EU measures taken in the natural gas field compliant with the international law rules binding the Union? How did the Lisbon Treaty change the EU approach to the energy regulation?

With reference to the structure of the natural gas market, we will test the hypothesis that EU-Russia energy relationship is not only about dependence, but also about interdependence. Moreover, we will also test the claim made by Russia regarding the putative incompatibility of Directive 2009/73/EC, regulating the EU natural gas market ('Gas Directive'), with the rules of the World Trade Organization ('WTO').[29] Lastly, we will assess the hypothesis that the introduction of a specific section related to energy in the Treaty on the Functioning of the European Union modified the energy relationship between the EU and its suppliers.

This research is significant because it analyses the EU-Russia energy relationship in the light of the mutable regulatory approach to energy of the EU legislator, which is still evolving. Indeed, some of the regulations looked at in this thesis were promulgated

[28] See chapter IV, section 3.

[29] Russia Federation, 'Request for Consultations by the Russian Federation' (2014) <https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%20@Symbol=%20(wt/ds476/1%20))&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#> accessed 24 August 2014.

between April and October 2017, which means we have an opportunity to be among the first to comment on them. More generally, the situation has significantly changed since 2010, and has been evolving in parallel with a renewal of interest in energy matters at the global level. Lastly, this thesis also closely examines the Gas Directive *vis-à-vis* WTO rules, a matter that is currently at the centre of a dispute pending before the WTO Dispute Settlement Body, whose outcome could severely affect the way the EU regulates its energy relations with third countries.

## 9. Methodology and Structure

Russia is by far the biggest gas supplier of the EU and in the last decade the EU-Russia energy relationship has been characterised by several political and legal contrasts. These are unique features among EU supplying countries. For this reason, in this work we have chosen to analyse the EU-Russia energy relationship.

We shall approach the issues outlined in this work from a legal perspective, and shall also take account of economic, practical and political considerations to enrich our analysis. This approach offers a clearer understanding of the current position of the EU with respect to its suppliers and of its likely position in the years to come.

The thesis is divided in five chapters. Chapter I will present the economic, political and legal backdrop to the EU-Russia energy relationship. It will begin with a description of the EU's natural gas market and explore the EU dependence on Russia. Finally, we will focus on the international legal instruments and on the domestic rules that apply between the EU and Russia.

Chapter II will outline the main features of the Gas Directive, the main piece of legislation regulating EU natural gas market, and consider its impact on third-country undertakings

operating in the EU, including Gazprom, the most important Russian State-controlled energy company. Lastly, chapter II will explain the reasons justifying the analysis of the Gas Directive *vis-à-vis* WTO rules.

Chapter III will consider the Gas Directive in the light of the WTO General Agreement on Tariffs and Trade and the General Agreement on Trade in Services and focus in particular on the anti-discrimination and the market access rules laid down under both agreements. The conclusion of the chapter will outline the impact of the legal investigation on the EU-Russia energy relationship.

Chapter IV begins with an overview of how the Lisbon Treaty impacted on the EU energy industry. It proceeds with a description of the Energy Union project and analyses two recent pieces of legislation, one relating to the intergovernmental energy agreements between EU members and third countries, and the other to the commercial agreements between natural gas market operators. We will then sum up the main characteristics of the post-Lisbon approach and outline its impact on EU-Russia energy relations.

Chapter V, which concludes the thesis, summarises the findings of the previous chapters and highlights some key points that could be useful for the future energy policies of the Union.

# I

## THE EU-RUSSIA ENERGY RELATIONSHIP

**Summary**: 1. Introduction – 2. Natural Gas: An Overview – 3. Focus on Russia – 4. The Game-Changers of the EU-Russia Energy Relationship – 5. International Legal Framework – 6. Internal Measures – 7. The Failure to Develop a Common EU Energy Approach Against Russia – 8. The Impact of Internal Measures at the International Level – 9. Interim Conclusion.

### 1. Introduction

This chapter underlines the importance of natural gas for the EU, especially in its relationship with Russia. It outlines the basic quantitative features characterising the field and the main characteristics of the EU-Russia interaction. It highlights that, notwithstanding the unilateral buyer-supplier relation, from an economic viewpoint interdependence is the key feature to interpret the EU-Russia energy relationship. This finding is important also from a legal perspective, since any internal regulatory issue in one country has much more impact on the other countries in case of strong economic interdependence.

Afterwards, the thesis tests the international legal framework applicable to the EU-Russia energy relationship in order to answer to the first question outlined in the introduction of this work.[1] We will underline that, except for World Trade Organization ('WTO') rules, applicable since Russia's accession in late 2012, there is no international legal tool currently able to influence the balance of power between the two parties. Indeed, the Partnership and Cooperation Agreement, the only bilateral agreement currently in force, lays down only general principles of cooperation between the two countries and its

[1] See Introduction, section 8.

provisions do not guarantee an effective enforcement. The same holds true for the other sources of international law.

In the absence of strong international law commitments, the relationship between the two countries has been widely crafted by the adoption of domestic protectionist measures. Both the EU and Russia adopted and enforced internal legislation targeting foreign entities which operate in their territory, imposing more demanding conditions than those applicable to internal companies. In addition to that, because of different energy mixes and dependency rates from Russian gas, single EU Members often negotiated on a bilateral basis with Russia. This led to a lack of coherence of the EU action in the field.

## 2. Natural Gas: An Overview

Natural gas is of utmost importance for the functioning of the European economy. The reliance of the EU on this fossil fuel dates back to after the end of the Second World War, when European countries used to grant exclusive concessions for the exploitation of their natural resources and increased during the Cold War, when the first pipelines supplying Eastern Europe from Russia were built.[2] Nowadays, natural gas utilisation has become very common and its importance is witnessed by the widespread diffusion of gas pipelines all across the continent, as illustrated by the following figure.

[2] The first pipelines connecting Russia and Countries Members of the European Community, now European Union, were built in 1982.

Figure 1: European Pipeline Network (Source: HIS Eurogas)

The EU currently imports 69.1% of the natural gas needed to fuel its economy, as it has insufficient internal production to cope with its demand of gas.[3] Russia is the biggest supplier of the Union, with a market share that in 2015 reached 29.4% of the European imports.[4] Other countries, namely Norway, Algeria, Qatar and Libya currently satisfy 25.9%, 8.8%, 6.1% and 1.7% of the European imports demand.[5]

The role of natural gas as a fundamental driver for economic development is not a phenomenon limited to Europe. Over the years, the importance of natural gas to satisfy the world's energy demand has steeply risen, also in countries of recent industrialisation such as China, which strongly incentivised investments in the natural gas field, to the

[3] Eurostat, 'Energy Production and Imports' (2015) <http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy_production_and_imports> last accessed 6 January 2018.

[4] Ibid.

[5] Ibid.

detriment of coal production.[6] Globally, natural gas consumption more than doubled from 1980 to 2016.[7] The discovery of new modalities for the transport of the resource, combined with its chemical characteristics (the percentage of carbon in natural gas is the lowest in carbon-intensive fossil fuels)[8] and its versatile uses in industry and at home, are at the basis of its current and future success.[9] Natural gas, which allows for less polluting emissions in respect of the other fossil fuels, is chosen as the principal source backing the development of green energies in case of their temporary insufficient production.[10]

Despite the importance of the gas imports for the European economy over the years and until mid-2000s, natural gas has not been at the centre of public debate. It was only in 2006, with the first of the so-called 'gas wars' between Russia and Ukraine, that the European security of supply came under the spotlight.[11] A dispute over transit fees for

[6] The Chinese natural gas incentive process started with the 12th five-year plan, which can be downloaded from the following link: <http://cbi.typepad.com/china_direct/2011/05/chinas-twelfth-five-new-plan-the-full-englishversion.html> last access 16 July 2017.

[7] British Petroleum, 'Statistical Review of the World Energy' (2015) <www.bp.com/...2015/bp-statistical-review-of-world-energy-2015-workbook.xlsx> last accessed 18 May 2017. In 2016, global natural gas production increased to 3552 billion cubic metres. In 1980 it amounted to 1448 billion cubic metres. See British Petroleum, 'Natural Gas Production' (2017) <https://www.bp.com/en/global/corporate/ energy-economics/statistical-review-of-world-energy/natural-gas/natural-gas-production.html> accessed 7 January 2018; Andrea Gilardoni, *The World Market for Natural Gas: Implications for Europe* (Springer 2008) 40.

[8] Ayhan Demirbas, *Methane Gas Hydrate* (Springer 2010) 68.

[9] Roderick Kefferputz, 'Shale Fever: Replicating the US Gas Revolution in Europe' (2010) CEPS Policy Briefs 201 <http://www.ceps.be/book/shale-fever-replicating-us-gas-revolution-eu> accessed 1 January 2014. For the International Energy Agency, natural gas will be the most popular energy source of the next 25 years. See International Energy Agency, 'World Energy Outlook 2016 Sees Broad Transformations in the Global Energy Landscape' (2016) <https://www.iea.org/newsroom/news/2016/november/world-energy-outlook-2016.html> accessed 7 January 2018.

[10] Elena Verdolini, Francesco Vona and David Popp, 'Bridging the Gap: Do Fast Reacting Fossil Technologies Facilitate Renewable Energy Diffusion?' (2016) National Bureau of Economic Research Working Paper 22454/2016 <http://www.nber.org/papers/w22454?utm_campaign=ntw&utm_medium=email&utm_source=ntw> last access 16 July 2017.

[11] The gas disputes between Russia and Ukraine are well described in Jonathan Stern, Simon Pirani and Katja Yafimava, 'The April 2010 Russo-Ukranian Gas Agreement and its Implications for Europe' (2011) 6 Oil Gas and Energy Law Journal; Sijbren de Jong, Jan Wouters and Steven Sterkx, 'The 2009 Russian – Ukranian Gas Dispute: Lessons for European Energy Crisis Management after Lisbon' (2011) 15 European Foreign Affairs Review 511.

gas destined for Europe, and the Russian decision to raise natural gas prices up to the European levels, led to the sudden interruption of Russia's supply to Ukraine.[12] Since Ukraine represented the most important transit country for the gas destined for Europe,[13] the interruption caused an immediate cessation of the Russian supply to several European countries, provoking serious emergencies for industrial production and house heating. During the emergency, Hungary – the most damaged country – lost 40% of its Russian gas supply, France, Romania and Slovakia about 30%, Italy 25% and Poland 14%.[14]

This event pushed the European institutions to take the problem of guaranteeing the security of natural gas supply in the old continent more seriously. An immediate acknowledgment of this potential problem was included in the 2006 green paper on 'European Strategy for Sustainable, Competitive and Secure Energy', where the European Commission ('EC') underlined the need for a concrete action of the European institutions to solve the problems related to the January 2006 events.[15] This document paved the way for the adoption of stronger regulatory measures in the natural gas market, as well as to actions aimed at diversifying the supply and enhancing energy efficiency.[16]

[12] Ibid.

[13] In 2006, 80% of the gas imported in Europe from Russia transited through Ukraine. After the emergency, the priority of the Union has been to diversify its supply sources and build new pipelines to be less dependent from the situation of a single country. In this regard, the Nord Stream pipeline plays a key role, bringing Russian gas to Germany bypassing Ukraine.

[14] Pami Aalto, *The EU-Russian Energy Dialogue: Europe's Future Energy Security* (Ashgate 2008) 23-41.

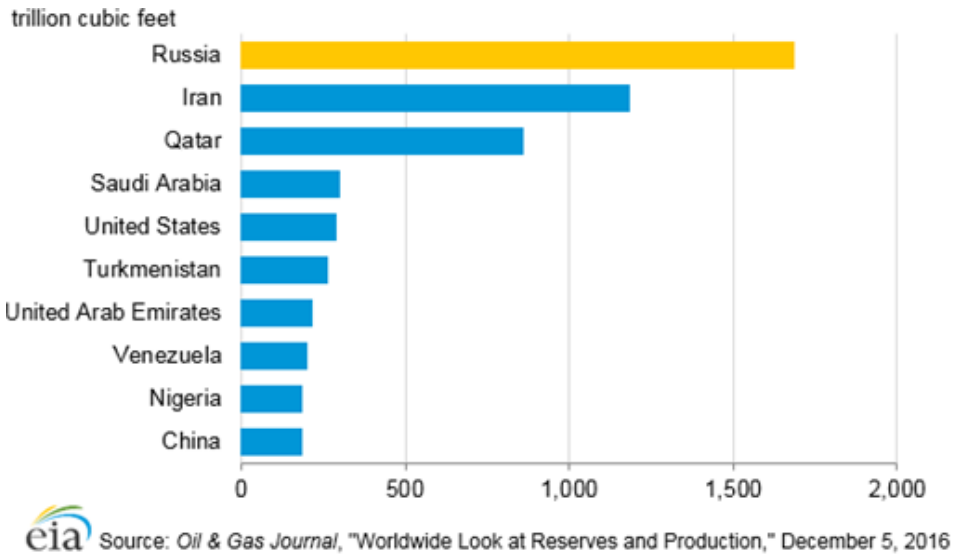
[15] European Commission, 'A European Strategy for Sustainable, Competitive and Secure Energy' COM (2006) 105 final.

[16] The evolution of the European energy policy will be analysed in chapter IV.

## 3. Focus on Russia

Among EU suppliers, the position of Russia deserves an in-depth analysis. According to the most recent statistics, Russia is the second biggest natural gas producer in the world, and also holds the largest reserves.[17] 2017 data show that Russia's proven reserves currently amount to 30% of the total reserves of the planet (see chart below). These records underline not only the primacy of the country for the satisfaction of the current EU demand, but also highlight its crucial importance for the future of the world's energy needs.[18]

Figure 2: Estimated proved natural gas reserves, as of January 2017




By virtue of Federal Law No. 117-FZ of 18 July 2006 'On Export of Gas', Gazprom is by law the sole company which can export the natural gas extracted in Russia. The legal monopoly on the export of the second natural gas producing country gives the company

[17] US Energy Information Administration, 'Russia' (2017) <https://www.eia.gov/beta/international/analysis.cfm?iso=RUS> accessed 27 November 2017. Russia estimated reserves amount to 1,688 trillion cubic feet (Tcf) (approximately 23850 billion cubic metres), as of January 2017.

[18] Ibid.

a tremendous market power, especially in terms of contractual bargaining when dealing with European clients. This contributes to the enormous value of the company, which, in 2011, was the most profitable undertaking of the globe.[19]

The position of EU Member States ('MSs') *vis-à-vis* Gazprom differs from one State to another. For historical reasons, Gazprom still enjoys a dominant position on transit and supply in most of Eastern European MSs that were formerly part of the Soviet Union. This picture significantly differs in Western Europe, where the situation is more fragmented, and EU MSs tend to be less dependent on Russian gas (see table 1, Eurostat). The price of the commodity differs from one EU country to another, depending on a variety of factors (e.g. bargaining power of buyers, prices set by competitors, historical ties etc.).[20]

Gazprom's strategic importance for Russia derives also from its shareholding structure. In fact, the major shareholder of the company is the Russian Federation, which owns a stake equal to 50.002%.[21] The position of control over the company is even more relevant when considering both the restrictions imposed by its internal by-laws and the Russian

[19] RT, 'Russia's Gazprom is the World Most Profitable Company – Forbes' (2012) <https://www.rt.com/business/gazprom-profit-list-forbes-391/> accessed 27 November 2017; RT, 'Gazprom No Longer World's Most Profitable Company' (2013) <http://rt.com/business/gazprom-profit-decline-lng-demand-615/> accessed 27 November 2017. ExxonMobil and Apple overtook Gazprom in 2012.

[20] Nathalie Hinchey and Anna Mikulska, 'LNG Versus Russian Gas in Central and Eastern Europe: Playing Poker on A Continental Scale' (2017) <https://www.forbes.com/sites/thebakersinstitute/2017/08/24/lng-versus-russian-gas-in-central-and-eastern-europe-playing-poker-on-a-continentalscale/#36de1ea22c3a> accessed 5 January 2018. Price differential between Eastern and Western European countries (up to 40%) has been heavily criticised by the European Commission in the antitrust investigation against Gazprom (see section 6.1.2). See also The Guardian, 'Brussels Accuses Gazprom of Unfair Pricing of Gas in Eastern Europe' (2015) <https://www.theguardian.com/business/2015/apr/22/brussels-accuses-gazprom-unfair-pricing-gas-eastern-europe> accessed 5 January 2018.

[21] The Russian Federation is represented by the Federal Agency for State Property Management. Other relevant participations are owned by the Bank of New York Mellon (26.95%) and 'other registered entities' (23.04%). Source: OAO Gazprom, '2012 Annual Report' (2012) 126 <http://www.gazprom.com/f/posts/55/477129/annual-report-2012-eng.pdf> accessed 19 November 2013.

laws regulating foreign investments in strategic companies, which require a prior governmental authorisation in case of third countries' companies willing to acquire a participation exceeding 5% of the voting share.[22]

Table 1: EU Dependence from Russian Natural Gas, 2016 (Source: Eurostat)

| **Country** | **Share (%) of Russia in extra-EU Imports of Natural Gas** |
|---|---|
| Belgium | 0-25 |
| Bulgaria | 75-100 |
| Czech Republic | 75-100 |
| Denmark | 0-25 |
| Germany | 50-75 |
| Estonia | 75-100 |
| Ireland | 0-25 |
| Greece | 50-75 |
| Spain | 0-25 |
| France | 0-25 |
| Croatia | 0-25 |
| Italy | 25-50 |
| Cyprus | 0-25 |
| Latvia | 75-100 |
| Lithuania | 25-50 |
| Luxembourg | 0-25 |
| Hungary | 75-100 |
| Malta | 0-25 |
| Netherlands | 25-50 |
| Austria | 75-100 |
| Poland | 75-100 |
| Portugal | 0-25 |
| Romania | 75-100 |
| Slovenia | 75-100 |
| Slovakia | 75-100 |
| Finland | 75-100 |
| Sweden | 0-25 |
| United Kingdom | 0-25 |

[22] Sergey Seliverstov, 'Energy Investments in the EU and Russia: Investment Regulation under the Third Energy Package and the Russian Law on Foreign Investments in Strategic Sectors' (2013) <www.rug.nl/research/...law.../s.seliverstov.pptx> accessed 22 November 2017; Tania Alves Calvao and Alexey Morozov, 'Russia and Brazil: Learning Each Other's Experience in Attracting Foreign Investments to Energy Sector' (2011) Oil Gas and Energy Law Journal 13-15 <http://www.ogel.org> accessed 28 September 2017. It is doubtful that foreign investors would be interested in participations in Russian entities of less than 25% minus one share. It is only starting with 25% that shareholders receive the following minimum set of rights necessary for corporate governance under Russian corporate law: right to block decision regarding amending the company's charter, right to increase or decrease the amount of charter capital; right to appoint representatives to the board of directors and to organise a shareholders' meeting.

The legal monopoly on the export of such a huge amount of natural gas, coupled with the control exercised by the Russian Government on the business strategies of the company and, consequently, on its subsidiaries, could make of Gazprom a powerful weapon in the hands of Russia for the management of its external relations.In addition to the above, the internal activity of the gas giant is of utmost importance for Russia in terms of the economic return generated for the country. In fact, Gazprom alone contributes for 8% of the Russian GDP, and almost a quarter of the overall Russian company income tax revenues yearly raised by the State.[23]

Moreover, Gazprom's strategic importance for Russia also derives from the application of a dual pricing policy, by which natural gas sold abroad is much more expensive than natural gas supplied inside the country.[24] This particularly holds true for natural gas supplied for domestic use, whereby prices are regulated at low non-market levels by the State.[25]

[23] Joseph Kuepper, 'Gazprom & Russia's Natural Gas Industry: The Risks & Rewards of Investing in Russian Natural Gas' (2013) <http://internationalinvest.about.com/od/globalmarkets101/a/Gazprom-and-Russias-Natural-Gas-Industry.htm> accessed 22 November 2013. These records mostly derive from the duties applied on the export of hydrocarbons. While reducing the export duties applied to several goods (*e.g.* leathers, mustard seeds, crabs etc.), the commitments made by Russia upon WTO accession did not modify the duties applied to natural gas, equal to 30%. See Sidley Austin LLP, 'Russia and the World Trade Organization: Consequences of Accession for the Russian Fuel and Energy Complex and Other Industries of Russian Economy' (2012) <http://rosenergo.gov.ru/upload/english.pdf> accessed 15 October 2013; David Tarr, 'The Crucial Role for Competition in the Russian Gas Market: Implications for Russia and Europe' (2013) International Association for Energy Economics <https://www.iaee.org/en/publications/newsletterdl.aspx?id=116> accessed 30 November 2013.

[24] See Ilaria Espa, 'The Role of the WTO in Addressing Regulatory Pricing Policies in the Energy Sector' in Photini Pazartzis and Maria Gavouneli, *Reconceptualising the Rule of Law in Global Governance, Resources, Investment and Trade* (Hart Publishing 2016) 391-404.

[25] This policy allows Russia to differentiate between clients in a way to enhance domestic welfare – social purpose – and support its internal economy. These effects have been heavily criticised, and this policy has been labelled by some as an illegal subsidy in favour of Russian domestic producers. See Alexander Jouravlev, 'The Effect of the European Union's Unbundling Provisions on the EU-Russia Gas Relationship and Russia's Accession to the World Trade Organization' (2011) 6 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969502> accessed 17 June 2017. Pursuant to the commitments made upon WTO accession, Russia will 'continue to regulate price supplies to households and to other non-commercial users, based on domestic social policy consideration'. See also Vitaliy Pogoretsky, 'The System of Energy Dual Pricing in Russia and Ukraine: The Consistency of the Energy Dual Pricing System with the WTO Agreement on Anti-Dumping' (2012) 4(10) Global Trade and Customs Journal <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2035581> accessed 25 September 2015. WTO

The monopolistic position of Gazprom on the export of Russian natural gas is an issue for the EU's security of supply. Nonetheless, the EU-Russia relationship cannot be seen, as some scholars suggest, merely as one that is at the mercy of the Russian company.[26] Even though Gazprom represents the most important – or even the sole – supplier of several European countries, in turn the EU is fundamental to satisfy Russia's security of demand which, for reasons related to the historical development of the infrastructure, is almost exclusively guaranteed by EU MSs.[27] Existing fixed infrastructure, combined with new projects' construction cost and time, make impossible for Russia to diversity its supply in the short-term.

In addition to that, the EU can leverage on several factors, such as its market size (500 million consumers), the adoption of energy efficiency policies to stabilise natural gas consumption and the possibility to incentivise the diversification of energy suppliers/supply sources. This supports former President of the Commission Barroso's statement according to which to date 'interdependence' is the most crucial aspect linked to the sale and utilisation of energy resources, and no company can pretend to act unilaterally for the satisfaction of its own interests without considering the others' view.[28]

members opposing dual pricing have historically argued that states administering dual-pricing policies are indirectly subsidising their energy intensive industries by providing them with cheaper inputs. Members maintaining dual pricing policies, on the other hand, believe they are merely exploiting their comparative advantage, using dual pricing as a development tool to diversify their economies, leaving the issue unsettled in the WTO. See Anna Marhold, 'Fossil Fuel Subsidy Reform in the WTO: Options for Constraining Dual Pricing in the Multilateral Trading System' (2017) International Centre for Trade and Sustainable Development (ICTSD) 6.

[26] Lisa Pick, 'EU-Russia Energy Relations: A Critical Analysis' (2012) Polis Journal 339.

[27] According to the European Commission, 70% of the gas exported by Russia is dispatched in Europe. See Eurostat, 'Energy Production and Imports' (2013) <http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy_production_and_imports/it> accessed 28 March 2016.

[28] Josè Barroso, 'Towards a New Energy Future: Showing Solidarity and Embracing Our Interdependence' (2009) <http://europa.eu/rapid/press-release_SPEECH-09-193_en.htm?locale=en> accessed 1 January 2014.

In other words, the relationships within the natural gas market should always be based on the mutual cooperation of the subjects involved.

## 4. The Game-Changers of the EU-Russia Energy Relationship

In the previous sections, we have highlighted the basic features which characterise the EU-Russia energy relationship. Accordingly, we can say that:

(i) the EU-Russia relationship is a very complex subject, in which public and private interests are very intertwined;

(ii) Natural gas has a key role in this relationship and, for the time being, its future success does not seem to be endangered by the development of renewable energies;

(iii) Geographical, historical and economic constraints make 'interdependence' a peculiar feature of the EU-Russia energy relationship.

The first two findings fully reflect the concepts outlined in the introduction of the thesis, where we described the characteristics of the energy market in general. In contrast, the third finding is an exception to the dependency relation theory outlined in the conceptual framework,[29] because of the fixed transportation infrastructure which bind the two parties. As mentioned in the introduction, this scenario could change because of economic, political and regulatory factors.[30]

From an economic perspective, the widespread diffusion of LNG and the progressive exportation of US shale gas could be a game-changer of the EU-Russia energy relationship, disrupting the paradigm constituted by pipeline connection. Nowadays,

[29] See introduction, section 4.

[30] See introduction, section 6.

more than 22% of the EU import capacity is guaranteed by LNG, which comprises 18% of EU imports.[31] However, the market evolution will very much depend on the price the source (nowadays LNG costs some 30% more than Gazprom's gas in Europe supplied through its 'most expensive' route, via Ukraine)[32] and on the investments required to ship gas to Europe. New technological discoveries reducing LNG costs, as well as modifications of existing geographical constraints (e.g. the melting of Arctic ice and the opening of new navigation routes) could be major drivers for the evolution of the current scenario.

Another aspect which could impact on the EU-Russia energy relationship is the game of political alliances of the two parties. In particular, the EU-US relationship could be a game-changer of the EU-Russia energy balance. In 2014, the EU followed the US and applied trade sanctions to Russia because of the annexation of Crimea.[33] This led not only to diplomatic consequences (e.g. the interruption of a new EU-Russia bilateral agreement and the exclusion of Russia from the G8 summit) but also impacted on energy sector activities, by denying the export of certain energy-related equipment and technology to Russia.[34]

In July 2017, the US Congress has approved harsher sanctions towards Russia, which could have important implications for Europe because they target any company that

[31] European Commission 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: On an EU Strategy for Liquefied Natural Gas and Gas Storage' COM (2016) 49 final.

[32] Elena Mazneva and Anna Shiryaevskaya, 'Putin's Russia Seen Dominating European Gas for Two Decades' (2017) <https://www.bloomberg.com/news/articles/2017-03-01/putin-s-russia-seen-dominating-european-energy-for-two-decades> accessed 12 November 2017.

[33] European Commission, 'EU Sanctions Against Russia over Ukraine Crisis' (2017) <https://europa.eu/newsroom/highlights/special-coverage/eu-sanctions-against-russia-over-ukraine-crisis_en> accessed 12 November 2017.

[34] Ibid.

contributes to the development, maintenance or modernisation of Russia's energy export pipelines.[35] The sanctions could affect the maintenance or upgrading of existing pipelines from Russia and elsewhere around the Caspian Sea which are participated by EU entities (e.g. Nord Stream 2 and Turkstream).[36] This situation created political tensions between the EU and the US administration, without any response agreed on by European leaders. The enforcement of the new sanctions could lead to the abortion of the projects concerned, aimed at increasing EU supply differentiation through the opening of at least two new transit routes for Russian gas to Europe bypassing Ukraine. In addition to the politically-motivated reason related to Crimea, the harshness of the sanctions imposed could be read as the US attempt to push the EU to purchase US shale gas instead of Russian gas.[37]

Lastly, the adoption of international and internal regulation schemes could impact on the EU-Russia energy relationship given the high economic interdependence existing between the two territories, seen above in the chapter. Indeed, the adoption of regulatory measures targeting foreign businesses operating or willing to operate in the reciprocal territory would affect the whole economic activities in the energy sector of the relevant country abroad. This is true especially in case of Russia. As seen, Gazprom contributes to a substantial amount of Russia's GDP and its foreign activities are almost exclusively developed in the EU.[38] In this context, legal changes could become a way to shape the

[35] For an overview of the US sanctions against Russia see <https://www.congress.gov/bill/115th-congress/senate-bill/341?q=%7B%22search%22%3A%5B%22russia+sanctions%22%5D%7D> accessed 12 November 2017.

[36] Both projects aim at supplying the EU with Russian gas bypassing Ukraine. The first project is a twin pipeline system through the Baltic Sea which connects Russia and Germany and doubles the capacity of the Nord Stream, already in operation (See <https://www.nord-stream2.com/> accessed 12 November 2017). The second projects will connect Russia and Turkey through pipelines laid under the Black Sea (see <http://www.gazpromexport.ru/en/projects/> accessed 12 November 2017. Both pipelines are sponsored by Gazprom.

[37] To date, the amount of US shale gas sold to Europe is minimal compared to Russian piped gas. OAO Gazprom, 'Investor Day' (2018) <http://www.gazprom.com/f/posts/41/295497/investor-day-2018-en.pdf> accessed 3 April 2018.

[38] See section 3 above.

reciprocal energy relationship. The effective impact of energy regulation on the EU-Russia relationship is the main topic of this work and will be analysed starting from the next section of this chapter.

## 5. International Legal Framework

As mentioned in section 5 of the introduction of this work, one of the key features of the energy market is the tendency to regulate the matter at the supranational level. This section analyses the international legal constraints tying the EU and Russia in the energy sphere, in view of determining which rules currently shape the EU-Russia energy relationship.

As we will see, lots of the provisions currently applicable are non-binding on the parties and are conceived as soft law mechanisms to enhance the cooperation between the EU and Russia.

To facilitate the reading, we will divide international law constraints between bilateral and multilateral tools.

### 5.1 Bilateral Tools

#### *5.1.1 Partnership and Cooperation Agreement and other EU-Russia Bilateral Tools*

Bilateral relations between the EU and Russia have predominantly been based on the Partnership and Cooperation Agreement (hereafter 'PCA'),[39] which was signed in 1994 and entered into force on 1st December 1997 for an initial duration of ten years. The agreement, which has been renewed annually since 2007, has provided a legal framework

[39] Agreement of Partnership and Cooperation Establishing a Partnership Between the European Communities and their Member States, of one part, and the Russian Federation, of the other part [1997].

for bilateral trade and has regulated political, economic and cultural relations between the EU and Russia. The PCA covers a wide range of policy areas; however, its focus has been aimed at promoting trade, investment and harmonious economic relations. Under Article 106, the PCA is automatically renewed unless either party gives notice of termination. Both the EU and Russia have agreed to leave it in place until a new agreement is signed.[40] The PCA therefore remains the basis for EU-Russia relations until replaced by a new agreement.[41]

All EU institutions have recognised the need to revise the legal framework of EU-Russia relations given the limitations of an incoherent energy policy towards Russia after EU enlargement.[42] Indeed, as regards to the regulation of the energy field in general, and of natural gas in particular, the PCA remains rather vague.[43] Article 65, which specifically targets the energy sector, provides that:

> Cooperation shall take place within the principles of market economy and the European Energy Treaty, against a background of the progressive integration of the energy markets in Europe.

In addition to Article 65, several other PCA provisions can have an indirect influence on the EU-Russia energy relation. These are the most favoured nation (Article 10),[44] freedom

[40] Katinka Barysch, 'Report from the 4th Friedrich-Ebert Stiftung and Foundation for Unity for Russia Roundtable' (2006) Friedrich-Ebert Stiftung 2 <http://www.cer.org.uk/pdf/partnership_with_russia_barysch_dec06.pdf> accessed 10 March 2015.

[41] Delegation of the European Union to Russia, 'Political Relations: Legal Framework' (2012) <http://eeas.europa.eu/delegations/russia/eu_russia/political_relations/legal_framework/index_en.htm> accessed 24 September 2016.

[42] Peter Van Elsuwege, 'Towards a Modernisation of EU-Russia Legal Relations?' (2012) 5 EU-Russia Papers, Centre for EU-Russia Studies, University of Tartu 3 <http://hdl.handle.net/1854/LU-2134081> accessed 8 September 2016.

[43] Ibid 6.

[44] Pursuant to Article 10 PCA: '1. The Parties shall accord to one another the general most-favoured-nation treatment described in Article I, paragraph 1 of the GATT. 2. The provisions of paragraph 1 shall not apply

of transit (Article 12(2)),[45] investment protection (Article 58 and Article 28),[46] and general insurance of a positive economic climate (Article 34).[47] However, some of these provisions (e.g. Articles 10 and 12) make explicit reference to World Trade Organization ('WTO') rules and are therefore redundant after the entry of Russia in the WTO (see section 5.2.2 below). Others (e.g. Articles 34 and 58) are more policy indications than prescriptive norms. In addition to the above, the non-binding character of the recommendations taken by the Cooperation Council,[48] makes the recourse to the PCA a palliative tool to protect the energy interests of the parties. For these reasons, the PCA, as it stands now, is not a suitable tool to regulate EU-Russia reciprocal relationships.

The challenges surrounding the modernisation of EU-Russia relations need to be addressed as Russia's withdrawal from the Energy Charter Treaty in 2009 (see section 5.2.1 below) has effectively rendered EU-Russia energy cooperation essentially based on non-legally binding dialogues and commitments, the most important being the EU-Russia

to: advantages accorded to adjacent countries in order to facilitate frontier traffic; advantages granted with the aim of creating a customs union or a free-trade area or pursuant to the creation of such a union or area; the terms 'customs union' and 'free trade area' shall have the same meaning as those described in paragraph 8 of Article XXIV of the GATT or created through the procedure indicated in paragraph 10 of the same GATT article; advantages granted to particular countries in accordance with the GATT and with other international arrangements in favour of developing countries'.

[45] Pursuant to Article 12(2) PCA: 'The rules described in Article V, paragraphs 2, 3, 4 and 5 of the GATT shall be applicable between the Parties'.

[46] Pursuant to Article 58 PCA: 'Bearing in mind the respective powers and competences of the Community and the Member States, cooperation shall aim to establish a favourable climate for investment, both domestic and foreign, especially through better conditions for investment protection, the transfer of capital and the exchange of information on investment opportunities'.

[47] Pursuant to Article 34(1) PCA: 'The Parties shall use their best endeavours to avoid taking any measures or actions which render the conditions for the establishment and operation of each other's companies more restrictive than the situation existing on the day preceding the date of signature of the Agreement'.

[48] Pursuant to Article 101 PCA: 'Each of the Parties may refer to the Cooperation Council any dispute relating to the application or interpretation of the Agreement. The Cooperation Council may settle the dispute by means of a recommendation. In the event it is not possible to settle the dispute by recommendation, either Party may notify the other of the appointment of a conciliator; the other Party must then appoint a second conciliator within two months. For the application of this procedure, the Community and its Member States shall be deemed to be one Party to the dispute. The Cooperation Council shall appoint a third conciliator. The conciliators' recommendations shall be taken by majority vote. Such recommendations shall not be binding upon the Parties'.

Energy Dialogue. This was conceived as a forum where all issues of mutual concern in the energy sector (gas, electricity, nuclear sectors) could be addressed. Over 100 experts nominated by Member States and Russia are active in the Energy Dialogue. Their main activity consists of identifying problems of the energy relations and working on common approaches to address them. The main issues over the years concerned investment, infrastructure, trade and energy efficiency. These issues are addressed within working groups through exchanging of views and information, sharing experience and performing studies. This approach has proven useful in removing much misunderstandings and even solving some sensitive issues within the EU-Russia energy relation. The groups can also make proposals, conclude understandings and cooperation agreements, and identify key (infrastructure) projects. However, despite positive influence on various areas of the EU-Russia energy relation, Energy Dialogue is 'only' an institutional mechanism of political cooperation. Thus, all its products bare a rather political, 'soft-law' value. The lack of legally binding decisions substantially diminishes importance of the Energy Dialogue for the EU-Russia energy relations.

The new EU-Russia Partnership Agreement (PA) was expected to provide a comprehensive framework for bilateral trade and investment relations, with a view to improving the regulatory environment by building upon the WTO rules and going beyond the PCA provisions.[49] The EU welcomed Russia's WTO membership and has been eager to pursue a deep and comprehensive economic integration agreement following Russia's accession.[50]

[49] European Commission, 'Trade – Russia' (2016) <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia/> accessed 14 September 2016. Negotiations on the new EU-Russia Partnership Agreement were launched at the 2008 Khanty-Mansyisk Summit.

[50] Rafael Leal-Arcas, 'The EU and Russia as Energy Trading Partners: Friends or Foes?' (2009) 14(3) European Foreign Affairs Review 348.

In this respect, the EU seems to be in favour of a new agreement with clearly defined terms on energy and security based on the Union's *acquis* which it hopes to export,[51] whereas it is unlikely that Russia, as a major gas exporter, will agree to a new PA with provisions incorporated through an extension of the EU's *acquis.*[52] In the same vein, despite Moscow's desire to remain outside the ambit of EU legal regulation, it is doubtful whether the EU will ever acquiesce to an agreement with Moscow on terms incompatible with EU law.[53] These manifestly inconsistent views have subsequently reduced negotiations on a revised bilateral framework to a piecemeal process. Furthermore, following Russia's annexation of Crimea, the EU has suspended all bilateral talks on the point. The EU and Russia can therefore be said to have entered a stalemate, with little sign of this state of affairs abating any time soon.[54]

### *5.1.2 EU Member States-Russia Bilateral Treaties*

In addition to the PCA and the other tools described in the previous section, EU-Russia energy relationships are shaped by the bilateral treaties ('BITs') signed between Russia and various individual EU Members.[55] A BIT is an international law instrument that has

[51] Andrei Konoplyanik, 'A Common Russia-EU Energy Space: The New EU-Russia Partnership Agreement, Acquis Communautaire and the Energy Charter' (2009) 27(2) Oil Gas and Energy Law Journal 261.

[52] Tatiana Romanova, 'The Russian Perspective on the Energy Dialogue' (2008) 16(2) Journal of Contemporary European Studies 223.

[53] Andrei Konoplyanik, 'Russia: Don't Oppose the Energy Charter, Help to Adapt it' (2009) 76(7) Petroleum Economist 2.

[54] Christian Nitoiu, 'Is Meaningful Cooperation Between the EU and Russia still Possible?' in Christian Nitoiu, *Avoiding a 'Cold War': The Future of EU-Russia Relations in the Context of the Ukraine Crisis* (LSE IDEAS 2016) 94.

[55] Hereafter, the list of the BITs signed by and between Russia and EU Members (date of signature/date of entry into force): Austria (1990/1991), Belgium (1989/1991), Bulgaria (1993/2005), Czech Republic (1994), Denmark (1993/1996), Finland (1989/1991), France (1989/1991), Germany (1989/1991), Greece (1993/1997), Hungary (1995/1996), Italy (1996/1997), Lithuania (1999/2004), Luxembourg (1989/1991), Netherlands (1993/1996), Romania (1993/1996) Slovakia (1993/1996), Spain (1990/1991), Sweden (1995/1996), United Kingdom (1989/1991).

a substantial impact on the energy relations between the contracting countries. Although not specifically aimed at energy, its provisions apply to a broad range of different assets that BITs consider as 'investments' and as such, they have a direct influence on the investments in the energy sector. Thus, BITs constitute a legal frame for the energy investments between the contracting parties. Amongst the typical provisions of the specific regime created by the BITs are the national and most favoured nation treatment, fair and equitable treatment, prohibition of unlawful expropriations, and guarantee of free transfer of funds. However, the protection granted under the single BIT largely depends on the specific wording of the clauses at issue.[56]

Pursuant to Article 351(1) TFEU:

> The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties.[57]

Therefore, in relation to BITs signed with non-EU countries prior to MSs' accession to the EU, the conflict between two incompatible obligations is resolved in favour of the BIT by EU law itself. Article 351(1) does not apply only to those agreements that breach the fundamental constitutional principles of EU law.[58]

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[56] For example, the agreements with Austria, Belgium, Luxembourg, Finland, Germany, Spain and the United Kingdom are provided with so-called 'narrow dispute resolution clauses', which limit the access to arbitration only to disputes concerning the amount or mode of compensation to be paid in case of expropriation. See Reinisch August, 'How Narrow are Narrow Dispute Settlement Clauses in Investment Treaties?' (2011) 2(1) Journal of International Dispute Settlement 117.

[57] Article 351 covers also secondary law sources. See Anthony Arnull, Catherine Barnard, Michael Dougan and Eleanor Spaventa, *A Constitutional Order of States? Essays in EU Law in Honour of Alan Dashwood* (Hart Publishing 2011) 135.

[58] Joined Cases C-402/05 and C-415/05 *Kadi & Al Barakaat Int'l Foundation v Council* [2008] ECR I-6351, 303-304.

The question of the inter-relationship between EU energy law and international investment law was at the centre of the *Commission v Slovakia* case before the Court of Justice of the European Union.[59] This dealt with the implementation of the second energy package in Slovakia, which negatively impacted on the priority access to the electricity network of a company owned by a Swiss investor.[60] The Court confirmed the applicability of Article 351(1) TFEU to the case at issue and considered that Slovakia was bound by international obligations towards the Swiss investor on the basis of the BIT concluded by the country with Switzerland before its accession to the EU and in compliance with the *pacta sunt servanda* principle.[61] The reasoning of the Court confirmed the opinion of Advocate General Jaaskinen.[62]

In addition to the above, one should consider instances in which the incompatibility between EU law and an international agreement comes at a later stage because of the adoption of new EU regulations or a new allocation of competence between the EU and its MSs. This is another situation in which MSs can derogate to EU law to respect the international obligations arising from the agreement signed and to comply with the *pacta sunt servanda* principle.[63] Following this line of reasoning, the German Federal

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[59] Case C-264/09 *Commission v Slovakia* [2011] ECR I-08065.

[60] The second energy package is an all-encompassing intervention issued in 2003 regulating the EU energy market. See section 6.1.1.

[61] Anatole Boute, 'The Protection of Russian Investments in the EU Energy Market: A Case in Support of Russia's Ratification of the Energy Charter Treaty' (2014) 29 ICSID Review 545. The *pacta sunt servanda* principle is included under the Vienna Convention on the Law of the Treaties and is recognised as a general principle of international law. See United Nations, *Vienna Convention on the Law of Treaties* (1969) Article 26.

[62] *Commission v Slovakia* (n 59).

[63] See Tilman Dralle, 'A Glance into the Future: The Prospective Investment Law Regime between the European Union and the Russian Federation' (2013) Dresden Research Paper on International Economic Law 2/2013 <https://tu-dresden.de/gsw/jura/ifve/jfoeffl9/ressourcen/dateien/globaltransaxion/veroeffentlichungen/DreRePIEL_paper_0213?lang=en> last accessed 2 January 2018.

Constitutional Court stated that 'a legally existing factual situation in the Member States will in principle not be adversely affected by a later step of integration'.[64] Similarly, in Regulation 1219/2012, establishing transitional arrangements for BITs between MSs and third countries, the EU legislator underlined that old treaties should be maintained until new agreements between the EU and the relevant non-EU country enter into force.[65]

It is worth mentioning that Article 351(2) TFEU requires MSs to 'take all appropriate steps' to eliminate any incompatibility between BITs in force and EU law, in order to preserve the principle of supremacy of EU law.[66] Although the TFEU refers to 'established' incompatibilities, in a series of cases dealing with BITs concluded with extra-EU countries, the Court of Justice of the European Union interpreted this clause as referred to all those risks which could create potential future conflicts, even if there are no actual incompatibilities.[67] Commentators criticised this broad interpretation which, paradoxically, would require MSs to denounce or renegotiate all their prior international agreements that fall under the scope of EU law.[68] Notwithstanding the similarities to the

[64] 2 BvE 2/08 30 June 2008, 380.

[65] European Parliament and Council Regulation 1219/2012 of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries' [2012] OJ L351, Art 3.

[66] Pursuant to Article 351(2) TFEU: 'To the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude'.

[67] Case C-205/06 *Commission v Austria* [2009] ECR I-1301; Case C-249/06 *Commission v Sweden* [2009] ECR I-1335; Case C-118/07 *Commission v Finland* [2009] ECR I-10889. See Alina Kaczorowska, *European Union Law* (4th edn, Routledge 2016) 279; Robert Schütze, *Foreign Affairs and the EU Constitution: Selected Essays* (CUP 2014) 108; Marc Bungenberg, Joern Griebel and Steffen Hindelang, *International Investment Law and EU Law* (Springer 2011) 86.

[68] See Schütze (n 67) 109, according to which, 'any international agreement falling within the competences of the Union would be incompatible with the effectiveness of (subsequently adopted) European legislation'. A way to solve the potential dispute would be a direct engagement of the Commission in the negotiation process. See Panos Koutrakos, *EU International Relations Law* (Hart Publishing 2015) 347; Marc Bungenberg and Christoph Herrmann, *Common Commercial Policy After Lisbon* (Springer 2013) 57; Jorun Baumgartner, *Treaty Shopping in International Investment Law* (OUP 2016) 25.

previous cases, in *Commission v Slovakia* the Court did not address this issue because the Commission has not pleaded Article 351(2).[69] Afterwards, the EU legislator seems to have clarified the matter with the adoption of Regulation 1219/2012.[70]

For the reasons above, in case of contrast between EU law and BITs between MSs and Russia it is reasonable to adopt the following interpretation: BITs find application 1) when they have been signed before the accession to the EU of the relevant MS; or 2) in the event of a supervened incompatibility due to a change in EU law. Most of the agreements with Russia were signed at the end of the Soviet era.[71] In case of Austria, Bulgaria, Czech Republic, Finland, Hungary, Lithuania, Romania and Slovakia, BITs were signed before their accession to the European Union and, therefore, should find application in case of incompatibility with EU law.[72] This means that BITs between EU MSs and Russia could hamper the application of EU law in a uniform way throughout the territory of the Union. For this reason, MSs' BITs do not seem to be the more appropriate legal tool to guarantee a coherent regulation of the EU-Russia energy relationship. As we will see in chapter IV, the Lisbon Treaty significantly impacted on this topic.

[69] Case C-264/09 *Commission v Slovakia* [2011] ECR I-08065, Opinion of AG Jaaskinen, paragraph 72. Article 12 of Regulation (EU) No 1219/2012 explains the conditions under which Member States are empowered to conclude and/or maintain in force bilateral investment agreements signed between 1 December 2009 (date of entry into force of the Lisbon Treaty) and 9 January 2013 (date of entry into force of Regulation (EU) No 1219/2012). Regulation (EU) No 1219/2012 has been issued on the basis of the new EU competence on foreign direct investments (see chapter IV, section 2.2).

[70] This will be analysed in detail in chapter IV, section 2.2.

[71] See footnote 55.

[72] Hereafter, the list of the countries with their accession year: Austria (1995), Bulgaria (2007), Czech Republic (2004), Finland (1995), Hungary (2004), Lithuania (2004), Romania (2007), Slovakia (2004). The application of the BITs signed with Russia is subject to the respect of Article 351(2) TFEU.

## 5.2 Multilateral Tools

### *5.2.1 Energy Charter Treaty*

Bilateral relations aside, from an international perspective the Energy Charter Treaty ('ECT') constitutes the only intergovernmental agreement in the energy field backed by an investor-State dispute settlement mechanism.[73]

The ECT covers various energy related fields, including investment, trade, transit, competition, energy efficiency, access to capital, transfer of technology and protection of environment.

Through its provisions, the ECT tends to create a stable and non-discriminatory regime for trade of energy materials and products between the contracting parties. This regime is based on the rules of WTO Agreements (see the next section below). Through reference to the WTO in its Article 4, the ECT thus applies the rules of the GATT/GATS to the ECT contracting parties that are not members of the WTO.[74]

In addition to trade, ECT transit provisions were seen as a key element during the initial negotiations, given that several ECT members are remote producing countries while others are major transit countries. Article 7 ECT lays down the rights and obligations concerning transit of energy through territory of a contracting state. This article mainly

[73] Yulia Selivanova, 'Managing the Patchwork of Agreements in Trade and Investment' in Andreas Goldthau and Jan M Witte (eds), *Global Energy Governance: The New Rules of the Game* (Brookings Institution Press 2010) 61. For a background, see Thomas Wälde, *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (1996 Kluwer Law International).

[74] Yulia Selivanova, 'The Energy Charter and the International Energy Governance' in Yulia Selivanova, *Regulation of Energy in International Trade Law: WTO, NAFTA and Energy Charter* (2011 Kluwer) 375-376.

'facilitates' transit in two ways: by granting access to existing networks and by encouraging construction of new transport capacity.

As regards to investments, the ECT distinguishes between two stages in the investment process and grants them a different protection. The pre-investment stage concerns access to foreign investors and it is protected by 'soft law' measures. Two interesting provisions in this regard are the 'standstill' provision of Article 10(5)(a) and the 'rollback' provision of Article 10(5)(b). The former requires contracting parties not to introduce new restrictions, while the latter mandates the reduction of existing restrictions on foreign investments.[75] The post-investment stage concerns investments already made and is protected by binding 'hard-law' measures. For this kind of investments, the ECT imposes several obligations on the contracting parties. Article 13 ECT protects foreign investors from unlawful expropriation. Article 10(1) protects investors from breaches of individual investment contracts. The same article obliges contracting parties to provide 'equitable and fair treatment' and 'most constant protection and security'. Lastly, national treatment and most favoured nation provisions oblige the contracting parties not to discriminate against investors from the ECT contracting states with regard to national and other foreign investors.[76]

The ECT regime is reinforced by a specific dispute settlement mechanism. This is a major confidence builder for foreign investors. ECT contains two forms of binding dispute settlement. Investor-to-State arbitration under Article 26 is provided for investment disputes. State-to-State arbitration under Article 27 concerns all disputes arising from the interpretation or application of the ECT (except disputes concerning competition and environment). Article 26(2) gives investors direct access to one of the international

[75] Angus C Johnston and Guy Block, *EU Energy Law* (2012 OUP) 286-289.

[76] Article 10(3) ECT.

arbitration forums, namely: International Centre for Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL), or the Arbitration Institute of the Stockholm Chamber of Commerce. The awards rendered under this dispute settlement mechanism are final and directly enforceable.

To date, the ECT has been signed or acceded to by fifty-two states, the European Union and Euratom (the total number of its signatories is therefore fifty-four).[77] Article 45(1) allows signatories to apply the treaty provisionally pending its entry into force, to the extent that such provisional application is not inconsistent with the constitution, laws or regulations of the country.[78] Despite the significance of the ECT as a legal framework in the energy field, Russia never ratified the treaty and instead opted for provisional application under Article 45(1) ECT.

Moscow, which had stalled on ratification, having linked it to consensus on the ECT Transit Protocol, finally announced that it would have terminated provisional application on 20 August 2009.[79] Russia's concerns were linked to the fact that the ECT did not sufficiently consider the interests of energy-producing countries and particularly those in foreign midstream and downstream energy markets.[80] Indeed, the perception of an Euro-

[77] Energy Charter, 'Members and Observers' (2017) <http://www.energycharter.org/who-we-are/members-observers/> accessed 1 May 2017.

[78] Article 45(1) of the Energy Charter Treaty reads: 'Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations'.

[79] Practical Law, 'Russia Withdrawing from Energy Charter Treaty' (2009) <http://uk.practicallaw.com/7-422-4842?service=dispute> accessed 24 September 2016.

[80] Boute (61) 526. According to Investopedia, 'midstream activities include the processing, storing, transporting and marketing of oil, natural gas and natural gas liquids'. 'Downstream operations can include refining crude oil and distributing its byproducts — such as gasoline, natural gas liquids, diesel and a variety of other energy sources — down to the retail level. The closer an oil and gas company is to the process of providing consumers with petroleum products, the further downstream the company is said to be'. See <https://www.investopedia.com/terms/m/midstream.asp> and <https://www.investopedia.com/terms/d/downstream.asp> accessed 15 April 2017. Upstream activities involve exploration, production or extraction.

centric nature of the ECT is well-grounded in the origins of the treaty, which was meant to be a tool to extend European investment interests into former communist countries.[81]

Russia's announcement to terminate provisional application and withdraw from the ECT deprived Russian investments of additional protection abroad, which should have been a source of concern, given Russia's issues with the Third Energy Package (see section 6.1.1 below).[82]

Indeed, Russian companies that invested in the other contracting parties were protected under the ECT before Russia's termination of the provisional application. Following the decision to terminate the agreement, these investors lost all the protection rights conferred by the ECT. Consequently, all the investments made by Russian companies in the EU after the termination notice are not protected under the ECT. According to Boute, only a new ratification of the ECT by Moscow would reactivate the right of Russian investors to challenge measures that the EU had adopted before Russia terminated its provisional application.[83] However, the same author argues that, given the special status of EU law under the ECT,[84] the eventual claim brought by a Russian investor would likely find a negative response by the appointed arbitral tribunal.[85]

[81] Thomas Walde, 'Arbitration in the Oil, Gas and Energy Field: Emerging Energy Charter Treaty Practice' (2004) Transnational Dispute Management 4. This view is supported by the words of the Tribunal in the Electrabel case, where the court claimed that 'a presumption of no-contradiction exists between the ECT and EU law'. See *Electrabel S.A. v Hungary* ICSID ARB/07/19 (30 November 2012) 4.134.

[82] Ibid. Only a new ratification of the ECT would reactivate the possibility for Russian investors of launching arbitration proceedings against the Third Energy Package on the basis of the rights that these investors benefited from before Russia terminated its provisional application. See Boute (n 61) 525.

[83] Boute (n 61) 541.

[84] See footnote 81.

[85] Boute (n 61) 545.

At the same time, Russia's withdrawal from the ECT did not have immediate consequences for foreign investment protection, given that an arbitral tribunal for the Yukos case held that Russia was bound by the ECT for investment pre-dating its withdrawal on 19 October 2009,[86] despite not having ratified the treaty.[87] In particular, in accordance with Article 45(3), investments made in Russia prior to the withdrawal date would be protected for an additional 20-year period.[88] Only new investments made after the termination notice do not enjoy the protection granted under the ECT.[89]

In light of the above, until a new ratification, the withdrawal of Russia renders the ECT unable to be used to assess the reciprocal regulations adopted in the energy sector and shape EU-Russia energy relationship.

[86] The Yukos case, which was believed to be politically motivated, is arguably the most controversial investment arbitration case of all time. As CEO of Russia's largest oil firm, Mikhail Khodorkovsky was arrested for alleged tax fraud and Yukos was subsequently dismantled and auctioned off. For an overview of the case see Richard Youngs, *Energy Security: Europe's New Foreign Policy Challenge* (Routledge 2009).

[87] EUobserver, 'Investors Call for Tough EU-Russia Energy Treaty' (2009) <http://euobserver.com/?aid=29084> accessed 10 September 2016; Konoplyanik (n 53) 3.

[88] After long and complex litigation proceedings, a final award was rendered in July 2014 of US$50 billion against the Russian State, however Russia appealed to the District Court of The Hague, which ruled in April 2016 that Russia was not bound by the ECT because it had not ratified the Treaty. This judgement has subsequently suspended any enforcement of Yukos-related fines, pending a final appeal by investors to the Supreme Court of the Netherlands. This view of non-applicability of the ECT to Russia is contentious. It therefore remains to be seen whether the view of non-applicability of the ECT to Russia is maintained in the appeal to the Supreme Court of the Netherlands. At the time of writing, the dispute is not settled yet.

[89] The definition of 'investment' under the ECT is very broad and covers 'every kind of asset, owned or controlled directly or indirectly by an investor including (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges; (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise; (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an investment; (d) intellectual property; (e) returns; (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any economic activity in the energy sector' (Article 1 ECT).

*5.2.2 WTO Agreement*

On 22 August 2012 Russia became a member of the WTO after almost 20 years of protracted negotiation. Russia's accession was perceived as a monumental occasion to definitively embrace a market economy model and deepening EU-Russia trade relations.[90] The occasion was also hailed as an opportunity to enhance the current legal framework, which was considered limited in nature under the PCA.[91]

During WTO negotiations, future Member States of the organisation proposed limited commitments in relation to energy. Several reasons explain this choice. First, WTO founders did not want to make large concessions considering the strategic importance of the sector for their internal security and geopolitical leverage. In this respect, when the Uruguay round took place,[92] the presence of national monopolies in Europe hampered the development of transnational energy trade. Second, energy producing countries were not founding members of the WTO, and therefore did not contribute when the agreements were drafted. Some of these countries entered WTO at a later stage (e.g. Qatar in 1996, Saudi Arabia in 2005 and Russia in 2012) while others, such as Libya and Algeria, are still not members.[93] Lastly, the presence of vertically integrated undertakings in national

[90] Guillaume Van der Loo, 'EU-Russia Trade Relations: It Takes WTO to Tango?' (2013) 40(1) Legal Issues of Economic Integration 7.

[91] Natasha Georgiou and Andrea Rocco, 'The Energy Union as an Instrument of Global Governance in EU-Russia Energy Relations: From Fragmentation to Coherence and Solidarity' (2017) 9(1) Geopolitics, History and International Relations 245.

[92] The Uruguay Round was the last of eight completed rounds of the GATT. It took place from 1986 to 1994 and led to the creation of the World Trade Organization with GATT remaining as an integral part of the WTO agreements. See World Trade Organization, 'The Uruguay Round' (2018) <https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm> accessed 7 April 2018.

[93] Not by chance, none of these countries, except Kazakhstan, are to date members of the ECT. The list of WTO members can be found here: <https://www.wto.org/english/thewto_e/ whatis_e/tif_e/org6_e.htm> accessed 18 July 2017.

markets did not allow to draw a net distinction between energy goods and services.[94] Only with the liberalisation of the sector this conceptual separation became clearer.[95]

Notwithstanding the limited commitments, the applicability of WTO rules, in particular those included under the General Agreement on Tariffs and Trade ('GATT') and the General Agreement on Trade in Services ('GATS') to the energy sector is indisputable.[96]

GATT regulates the international trade of goods of any kind between MSs of the organisation. However, it does not define the concept of a 'good' as such.[97] According to the WTO Secretariat, the main characteristic to define a product as a 'good' in the meaning of the GATT is the 'storability',[98] for which a product is storable when it can be put in a place where it is available for future use.[99] In this respect, natural gas can be

[94] Wen-Chen Shih, 'Energy Security, GATT/WTO, and Regional Agreements' (2009) 49 Natural Resources Journal 440.

[95] Thomas Cottier, Garba Malumfashi, Sofya Matteotti and Olga Nartova, 'Energy in WTO Law and Policy' in Thomas Cottier and Panagiotis Delimatsis, *The Prospects of International Trade Regulation: From Fragmentation to Coherence* (CUP 2011) 3. Further comments on the inadequateness of the WTO rules in relation to energy can be found in Yulia Selivanova, 'International Energy Governance' (2012) American Society of International Law Proceedings 394 -396.

[96] WTO rules do not provide for an adequate energy investment regime. The scope of the TRIMs is limited to the trade-related effects of the investments only and its application to investments in the energy sector has been put under question by many. Similarly, other WTO agreements can have an impact on the energy sector, although less pronounced then the above discussed GATT and GATS. See Catherine Redgwell 'International Regulation of Energy Activities' in Martha M Roggenkamp, Catherine Redgwell, Inigo Del Guayo and Anita Ronne (eds.), *Energy Law in Europe: National, EU and International Regulation* (2007 OUP) 137-138.

[97] Thomas Cottier, Sofya Matteotti-Berkutova and Olga Nartova, 'Third Country Relations in EU Unbundling of Natural Gas Markets: The 'Gazprom Clause' of Directive 2009/73 EC and WTO Law' (2010) NCCR Working Paper 6/2010, 9 <http://www.nccr-trade.org/publication/third-country-relations-in-eu-unbundling-of-natural-gas-markets-the-gazprom-clause-of-directi/> last accessed 26 August 2014.

[98] WTO Secretariat, *Guide to the GATS, An Overview of Issues for Further Liberalization of Trade in Services* (Kluwer Law International 2001) 26. See also Danae Azaria, 'Energy Transit under the Energy Charter Treaty and the General Agreement on Tariffs and Trade' (2009) 27(4) Journal of Energy & Natural Resources Law 565; Nurlan Kurmanov, 'Transit of Energy Resources Under GATT Article V' (2013) 32(4) International Energy Law & Regulation 178; Rafael Leal-Arcas, 'The Resumption of the Doha Round and the Future of Services Trade' (2007) 29(3) Loyola of Los Angeles International & Comparative Law Review 362.

[99] Merriam Webster, definition of 'storable'.

stored in its natural state inside old depleted natural gas fields. This technique, commonly referred to as 'gas storage', is used to accumulate significant amounts of natural gas during times of lower consumption in order to prevent unexpected shortages during high-consumption periods.

Like the definition of 'good' under the GATT, the meaning of the term 'service' is not laid down under the GATS. However, this agreement sets out four different modalities in which a service can be traded, and it is therefore subject to its rules.[100] First, a service can be supplied from the territory of one country to another country (so-called 'cross-border supply'). Second, consumers from one country can use a service in another country (so-called 'consumption abroad'). Third, a company of one country can set up a branch and/or a subsidiary in another country and provide services therein (so-called 'commercial presence'). Lastly, people can move from one country to another and provide services in the latter (so-called 'movement of natural persons').

In case of natural gas, trade in services is made through cross-border supply and commercial presence. The WTO services classification (W/120), a comprehensive list of services sectors and sub-sectors covered under the GATS used for WTO accession, does not include a specific section on energy. However, gas related activities can be retrieved in three sub-sections: (i) services incidental to mining, rendered on a fee or contract basis at oil and gas fields; (ii) services incidental to energy distribution; and (iii) transportation via pipeline of crude or refined petroleum and petroleum products and of natural gas.[101] Services which are closely related to the production of the goods are not covered by the GATS. In this case the GATT finds application, because the production-related services

[100] See Article I, GATS.

[101] W/120 classification, <www.wto.org/english/.../mtn_gns_w_120_e.doc> last accessed 14 September 2014.

cannot be separated from the good itself.[102] In the gas field these activities are, for example, liquefaction and gasification.[103]

The applicability of WTO treaties to the energy sector and the fact that both the EU and Russia are members of the organisation make WTO rules a valuable option to enforce EU's and Russia's reciprocal stances.

Furthermore, Article 23(1) of the WTO Dispute Settlement Understanding ('DSU') provides that the jurisdiction of the WTO dispute settlement mechanism is compulsory and exclusive in nature for disputes that arise out from any of the WTO covered agreements.[104] Strict timeframes are established for the various stages of the dispute settlement process. The final remedy for a breach of the WTO provisions established by the WTO adjudication is the withdrawal or amendment of the WTO-inconsistent measure. DSU also provides for temporary remedies like compensation and suspension of concessions (retaliation).[105]

*5.2.3 Custom and other International Law Sources*

In the previous sections we analysed the bilateral and multilateral treaties binding the EU and its Members to Russia. In addition to that, the EU-Russia gas relationships can be shaped, at least in principle, by international custom.[106]

[102] Yulia Selivanova, 'The WTO and Energy' (2007) ICTSD Issue Paper 01/2007 <http://ictsd.org/i/publications/11229/> last accessed 18 January 2017.

[103] Ibid.

[104] Article 1 DSU.

[105] Article 22 DSU.

[106] Article 38 of the Statute of the International Court of Justice identifies the following sources of international law: international conventions; international custom; the general principles of law recognised by civilised nations; judicial decisions and the teachings of the most highly qualified publicists of the various nations (these latter as subsidiary means of interpretation).

Customary rules are particularly significant where the relations between States are not subject to an agreement. Even where a treaty is in force, customary rules find application to fill in *lacunae*, when there is a specific reference in the treaties or as a source of interpretation of these latter.[107] As it is widely known, the creation of a customary rule requires the presence of two elements: general practice and *opinio iuris*.[108] Once identified, custom applies to all countries and can therefore be invoked by any foreign investor, irrespective of whether its State of origin has entered into a BIT with the country where the investment is made, with the exception of the so-called 'persistent objectors'.[109]

Over the years, the role of custom dramatically decreased in the investment dispute settlement, as well as in the discussions between commentators and practitioners. Even the OECD admitted that the blooming of BITs requiring prompt, adequate and effective compensation deprived the debate on customary rules of practical significance for foreign investors.[110] Indeed, the rapid growth of BITs can be explained by the failure of customary rules to provide sufficient guidance and protection for the investments made. This was underlined in the widely-known *Barcelona Traction* case.[111]

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[107] Moshe Hirsh, 'Sources of International Investment Law' (2011) International Law Association Study Group on the Role of Soft Law Instruments in International Investment Law, 15-17 <https://ssrn.com/abstract=1892564> accessed on 6 April 2017.

[108] Article 38(1) of the Statute of the International Court of Justice sets out these two requirements.

[109] See, among the others, James A Green, *The Persistent Objector Rule in International Law* (OUP 2016).

[110] OECD, 'Indirect Expropriation and the Right to Regulate in International Investment Law' (2004) OECD Working Paper on International Investment 04/2004 <https://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf> accessed 2 January 2018.

[111] *Barcelona Traction Light and Power Co Ltd. (Belgium v Spain)* [1970] ICJ Rep 4 46-47, where the ICJ stated that: 'Considering the important developments of the last half century, the growth of foreign investments and the expansion of the international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of States have proliferated, it may at first sight appear surprising that the evolution of law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane'. The *Barcelona Traction* case describes a situation which has remained unchanged to these days. Commenting on the US 2004 model BIT, Judge Schwebel, former president of the ICJ, pointed out that the lack of consensus among capital importing and capital exporting countries led to the impossibility of defining a

The contested utility of customary international law to protect investments in the absence of a BIT has again been the object of discussion in *Diallo*, a case dealing with the compensation of a Guinean majority shareholder and manager of two companies he had been doing business with in Zaire (Mr Diallo), who was arrested and expelled from the country.[112] Guinea acted in support of Mr Diallo by providing diplomatic protection, a 'classic' defensive action under public international law through which a State has the discretionary right to protect its natural or legal nationals injured abroad.[113] In *Diallo*, the International Court of Justice ('ICJ') observed that:

> In contemporary international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements for the protection of foreign investments, such as the treaties for the promotion and protection of foreign investments, and the Washington Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States, which created an International Centre for Settlement of Investment Disputes ('ICSID'), and also by contracts between States and foreign investors. In that context, the role of diplomatic protection somewhat faded, as in practice recourse is only made to it in rare cases where treaty regimes do not exist or have proved inoperative.[114]

common standard of protection applied by all countries. See Stephen M Schwebel, 'The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law' 3(2) (2006) Transnational Dispute Management 3.

[112] *Ahmadou Sadio Diallo (Republic of Guinea v Democratic Republic of the Congo) (Preliminary Objections)* [2007] ICJ Rep 103.

[113] See, among the others, Chittharanjan Felix Amerasinghe, *Diplomatic Protection* (OUP 2008).

[114] Ibid 582, 614(88).

The overall compensation awarded by the ICJ to Guinea was minimal considering the amount claimed. Whilst the amount sought was US $11.5 million, the total sum awarded was US $95,000. Guinea's claims in terms of loss of earnings and loss of potential earnings were rejected by the Court.[115]

In the context of *Diallo,* it seems that the incorporation of local subsidiaries precludes an effective relief by means of diplomatic protection. This concern is expressed also in the joint opinion of two dissenting judges, who argued that '[T]he low standard of protection of shareholders under customary law is now confined to the wretched of the earth like Mr. Diallo … we believe that this case sets a dangerous precedent for foreign investors unprotected by bilateral investment treaties'.[116]

For the reasons above, as outlined by McLachlan, three decades after the *Barcelona Traction* case we still cannot define what the international jurisprudence includes in the 'minimum standard of treatment' of an investor under customary international law.[117] Indeed, the elements of widespread practice and self-observed legal obligation, required for the formation of a customary rule, are not apparently well adapted to meet the pressing problems of the day.[118]

[115] *Ahmadou Sadio Diallo (Republic of Guinea v Democratic Republic of the Congo) (Judgment)* [2012] ICJ Rep 324 56-57.

[116] Ibid 701.

[117] Campbell McLachlan, 'Is There an Evolving Customary Law on Investment?' (2016) 31(2) ICSID Review 260.

[118] Ibid 261.

Similar considerations to the ones made about custom find application in case of general principles of law, the other source of international law listed by Article 38 of the ICJ statute.[119]

In the light of the above, international custom cannot be considered as an effective way to shape EU-Russia energy relationship.

### 5.3 Conclusive Remarks on the Applicability of International Law Tools

In the absence of strong bilateral commitments and considering the limited protection of multilateral law remedies except WTO rules (applicable between the parties only since 2012), over the years the EU and Russia adopted protectionist measures to limit the access to their energy resources and infrastructure. In this context, restrictions on energy investments and retaliations to gain political leverage became the order of the day in EU-Russia energy relations.[120] This clearly leaves room for opportunistic and politically motivated decisions which could hamper the development of the energy projects

[119] As for the principles of law, through an empirical analysis Fauchald demonstrated that contemporary arbitral tribunals seem to have largely neglected them. Indeed, only in 8 occasions out of 98 cases analysed between 1998 and 2006 investment tribunals examined general principles of law as a separate legal basis to release their award, and in 4 cases only they made use of general principles as interpretative source for their decisions, albeit as a non-essential interpretative argument. General principles have a residual nature and international tribunals tend to use them to fill remaining gaps in treaty and customary law. Moreover, the employment of this source of law is accompanied by a high degree of subjectivity and it generally grants much latitude to international tribunals. See: Ole K Fauchald, 'The Legal Reasoning of ICSID Tribunals – An Empirical Analysis' (2008) 19 European Journal of International Law 301-304. Fauchald analyses also judicial decisions and teaching of the most renowned scholars, expressly defined as subsidiary means of interpretation by the ICJ statute. Even if this does not imply the existence of any binding doctrine of precedent, judicial decisions of other tribunals are often used to develop a *jurisprudence constante* which is commonly cited to solve the case at hand. This constitutes a remarkable feature of the contemporary investment protection regime. See Jean D'Aspremont, 'International Customary Investment Law: Story of A Paradox', in Brabandere and Gazzini, *Sources of Transnational Investment Law* (Martinus Nijhoff 2012) 51; *Suez, Sociedad General de Aguas de Barcelona S.A. & Vivendi Universal S.A. v Argentine Republic*, ICSID ARB/03/19 (30 July 2010).

[120] Andrei Belyi, 'Reciprocity as a Factor of the Energy Investment Regimes in the EU-Russia Energy Relations' (2009) 2(2) Journal of World Energy Law & Business 123.

concerned with negative consequences on the welfare of final consumers.[121] All of this will be analysed below.

## 6. Internal Measures

In the previous sections, we analysed the multilateral and bilateral legal tools which could impact on the EU-Russia energy relationship. This section outlines the internal regulatory measures taken by the EU and Russia to shape their domestic natural gas markets which could impact on third countries' companies.

### 6.1 EU Measures

In section 3 of this chapter we have seen that interdependence is one of the key characteristics of the EU-Russia relationship due to geographical, economic and physical constraints. While EU energy legislation is only binding on EU MSs and the Energy Community countries,[122] it will nevertheless have implications for other third countries, by promoting or hindering energy trade and investments.

During the 1990s, when most national electricity and natural gas markets were still monopolised, the European Union and the Member States decided to open these markets gradually to competition. The first liberalisation directives (First Energy Package) were adopted in 1996 (electricity) and 1998 (gas), to be transposed into Member States' legal systems by 1998 (electricity) and 2000 (gas). The Second Energy Package was adopted in 2003, its directives to be transposed into national law by 2004, with some provisions

[121] Sijbren De Jong, Jan Wouters and Steven Sterk, 'The 2009 Russian-Ukrainian Gas Dispute: Lessons for European Energy Crisis Management after Lisbon' (2010) 15(4) European Foreign Affairs Review 525.

[122] The Energy Community Treaty is an international agreement signed in Athens on 25 October 2005, through which State parties, all non-EU Members, committed themselves to liberalise their energy markets according to the EU *aquis* and the CJEU case-law. To date, the members of the Energy Community are: Albania, Bosnia and Herzegovina, Montenegro, Ukraine, Kosovo, Moldova, Serbia, Macedonia (as parties); Georgia, Armenia, Norway, Turkey (as observers).

entering into force only in 2007. With the adoption of the first two packages, industrial and domestic consumers were now free to choose their own gas and electricity suppliers from a wider range of competitors.

The last significant action regulating the European energy market was the Third Energy Package. This was adopted in March 2009, before the Lisbon Treaty, and repealed the Second Energy Package.

The most significant piece of natural gas legislation included under the Third Energy Package is Directive 2009/73/EC (hereafter, 'the Gas Directive'), which is of utmost importance in the context of the pro-competitive steps taken by the European Union to achieve a single European energy market.[123] It was published on 13 July 2009, after two and a half years of negotiations which followed the 2007 Energy Sector Inquiry.[124] This latter, which consisted of a thorough analysis of the levels of competition present in the European electricity and natural gas markets following the first two energy packages,[125] depicted a critical situation in regards to the competitive environment and the liberalisation processes. According to the European Commission, this situation had to be attributed to structural deficiencies derived from the domination of the historical

[123] The single European energy market is part of the single European internal market, one of the final objectives of the European Union since its constitution by means of the Rome Treaty (1957). It is in the Rome Treaty that we find the first references to the internal market, specifically in Article 14, for which the Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market, and, among the others, the rules established to promote competition, under Arts 81 and 82. Afterwards, with the 1986 European Single Act and the 1992 Maastricht Treaty (or Treaty of the European Union 'TEU') the desire to achieve a true common market greatly increased. Accordingly, Article 3(3) TEU provides that one of the EU's objectives is a highly competitive social market economy.

[124] European Commission, 'DG Competition Report on Energy Sector Inquiry' SEC (2006) 1724.

[125] The first two energy packages adopted by the European legislator are not described in this thesis. However, useful information can be retrieved from Energy Community Secretariat, 'The Energy Community: The Legal Framework' (2010) <http://www.energy-community.org/pls/portal/docs/808177.PDF> accessed 26 November 2013; Enrico Salerno, 'L'Attuazione della Prima Direttiva sul Gas Naturale (98/30/CE) e le Modifiche Introdotte dalla Nuova Direttiva (2003/55/CE)' in Laura Ammannati, *Monopolio e Regolazione Pro-Concorrenziale nella Disciplina dell'Energia* (Giuffrè 2005) 184.

operators of the national markets, which led to a persisting national concentration, a consequence of too little integration and too little interconnection between Member States. This was coupled with the chronic lack of transparently available market information, the consequent distrust in the pricing mechanisms, and the presence of long-term downstream contracts tying big importing customers.[126] Along with the need to strengthen sectoral regulation, the EC described as beneficial the antitrust enforcement to cope with problems related to the presence of vertically integrated operators foreclosing the market.[127]

In response to the findings of the Energy Sector Inquiry, the Gas Directive provided for several actions. In particular, it introduced stronger unbundling measures, while guaranteeing incentives for investments in infrastructure by allowing for the derogation of the provisions on unbundling and third party access to pipelines on a case-by-case basis. Moreover, it provided enhanced powers for the national regulatory authorities, also in respect to dispute settlement mechanisms. Lastly, it set out rules to regulate the behaviour of third country entities in the EU, by expressly extending the regime applied to domestic companies and adding specific requirements as condition to operate in the EU territory.[128]

### 6.2 Russia Measures

The Third Energy Package and its provisions on third countries' companies (see chapter II) were intended to address concerns in Brussels regarding restrictions imposed on EU

[126] European Commission (n 124) 4; Victor Von Hoorn, ''Unbundling', 'Reciprocity' and the European Internal Energy Market: WTO Consistency and Broader Implications for Europe' (2009) 18 European Energy and Environmental Law Review 55.

[127] European Commission (n 124) 12.

[128] All these measures will be described in chapter II.

companies trying to invest in Russia's energy market.[129] The Yukos case of 2003 served as a stark reminder of the lengths to which the Russian state would go to retain control over its oil and gas sector.[130] However, the cases of Sakhalin II[131] and Shtokman[132] in 2006 raised the most concerns in Brussels as both cases were flagrant examples of arbitrary state intervention in the oil and gas sector. Further concerns were raised with Russia's adoption of the Law on Foreign Investments in Strategic Companies (Law 57-FZ) in April 2008,[133] which set out the oil and gas sector as a strategic sector for which investment now required government approval.[134] As a result, foreign investors were required to obtain consent for any acquisition in excess of 50% in companies deemed to be strategic, which enabled the designated authority to monitor the activities of foreign investors in the energy sector and other sectors of the economy.[135]

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[129] Belyi (n 120) 124. See also Peter Van Elsuwege, 'Towards a Modernisation of EU-Russia Legal Relations?' (2012) EU-Russia Papers 5, Centre for EU-Russia Studies, University of Tartu 24 <http://hdl.handle.net/1854/LU-2134081> accessed 8 September 2016.

[130] See footnote 86.

[131] Sakhalkin II, an oil and gas development project on Sakhalin Island in Russia, was governed by a Partnership Sharing Agreement which meant that the Russian state could not receive any profit until all costs incurred by the foreign company had been recovered. Shell was criticised of the high cost overruns which had subsequently brought about massive losses to the Russian Federation, including serious environmental damages to the region. All environmental concerns and issues regarding the project were swiftly resolved when Shell agreed to sell a majority stake in the project to Gazprom.

[132] Shtokman is one of the world's largest gas fields, for which Gazprom was in need of a partner as it lacked the necessary advanced technology to extract gas from this field. A short list of candidates was announced in September 2005, which included Norwegian Statoil and Norsk Hydro; American ChevronTexaco and ConocoPhillips; and French Total. Lengthy negotiations ensued until Gazprom finally declared that it no longer needed a partner, which was due to the fact that the candidates had not made a substantial enough offer of a stake in exchange for Shtokman. A decision was finally made in 2007 when Total, Statoil and Norsk Hydro finally agreed to become partners with Gazprom.

[133] Law 57-FZ 'On the Procedure for Contributing Foreign Investments in Legal Entities which are of Strategic Importance for the Defence of the Country and Security of the State' (so-called 'Law on Foreign Investments in Strategic Companies').

[134] Article 7 Law 57-FZ. See also Sergey Seliverstov, 'Energy Security of Russia and the EU: Current Legal Problems' (2009) Note de L'Institut Francais des Relations Internationales (IFRI) 16.

[135] Seliverstov (n 134). Law 155-FZ of 1 July 2017 amended Law 57-FZ by extending the special regulation (and thresholds) for approval of transactions which is established by Law 57-FZ for foreign state-controlled investors (i.e. foreign states and international organisations, except for such organisations listed in the Order of the Russian Government No. 119-r dated 3 February 2012 and organisations under their control) on offshore companies and organisations controlled by these. See White & Case LLP, 'Amendments to the

The subsequent amendment of a number of laws, in particular the 2008 revision of the Russian Law on the Subsoil,[136] was another cause for concern in Brussels. Law 58-FZ amended and repealed certain legislative provisions, including the Law on the Subsoil, which was the fundamental legislative act and general framework for licensing, exploration and development activities relating to natural resources in Russia.[137] The 2008 amendment enabled the Russian government to grant approval to terminate the right to mineral exploration and production whether the foreign entity had a license or not.[138] Significantly, the license could only be granted to Russian entities controlled by the state, with at least a five-year experience in the field.[139] As a result of these limitations, only Gazprom and Rosneft qualified for the licenses.[140]

Following the opening of the 2012 EU antitrust investigation towards Gazprom,[141] the Kremlin adopted Decree No. 1285/2012 'On Protection Measures for the Interests of the Russian Federation When Russian Legal Entities Perform Their Foreign Economic

Russian Strategic Investments Law: Special Regulation for Transactions Involving Offshore Companies' (2017) <https://www.whitecase.com/publications/alert/amendments-russian-strategic-investments-law-special-regulation-transactions> accessed 15 April 2018.

[136] Law 2395-121, dated 21 February 1992 'On Subsoil'.

[137] Kaj Hóber, 'Law and Policy in the Russian Oil and Gas Sector' (2009) 27(3) Journal of Energy & Natural Resources Law 432.

[138] Ibid 438.

[139] Seliverstov (n 134) 17.

[140] Ibid 18.

[141] In September 2012, the EC formally opened proceedings against Gazprom. The Commission acted in consequence of the concerns – motivated by informal complaints filed by some importing countries – that Gazprom might have abused its dominant market position in Central and Eastern European Member States, in breach of Article 102 TFEU. The Commission investigation, the widest ever made within the European energy market, assessed whether to charge the Russian gas giant with exclusionary behaviours, such as market partitioning, obstacles to network access, barriers to supply diversification, as well as possible exploitative behaviour, such as excessive pricing. Case updates can be retrieved from European Commission, 'Antitrust Cartel Cases: 39816 Upstream Gas Supplies in Central and Eastern Europe' (2018) <http://ec.europa.eu/competitio n/elojade/isef/case_details.cfm?proc_code=1_39816> accessed 22 March 2018.

Activities', prohibiting from that day forward those Russian companies (and their subsidiaries) included in the definition of 'strategic companies' under Decree No.1009/2004 to (i) provide information regarding the company activities, except those disclosed according to the Russian law; (ii) amend contracts entered into by the strategic companies with foreign counterparts, and any other documents related to commercial policy of the strategic companies in the foreign states; and (iii) dispose of shares in foreign companies, rights to conduct business activity in the foreign states, or immovable property located abroad; when requested by foreign states, international organisations, unions of foreign states, or bodies (institutions) of these organisations (including their regulatory or/and controlling bodies), without the previous consent of the competent Russian authority.[142]

Decree 1285/2012 authorised a supervising body to refuse the required consent in case of actions that could harm Russia's 'economic interests'. The meaning of this expression has remained undefined.[143] The timing of the issuance of the Decree 1285/2012 – one week after the opening of the EU investigation – reveals that this protective measure was adopted in retaliation to the EU action, as an attempt to hamper the EC's investigation.

## 7. The Failure to Develop a Common EU Energy Approach against Russia

Inconsistencies between the EU's Third Energy Package and Russia's unfavourable foreign investment climate were brought to the fore in 2014 by the South Stream case. This related to a joint venture between Russia, six EU countries (Bulgaria, Hungary, Greece, Slovenia, Croatia and Austria) and Serbia (member of the Energy Community)

[142] White and Case LLP, 'Strategic Companies' (2012) <http://www.russianlawonline.com/content/strategic-companies> accessed 22 November 2013.

[143] Andrey Konoplyanik, 'The EU Versus Gazprom' (2012) 372 Energy Economist 4.

regarding the South Stream gas pipeline, one of the most important gas supply projects engineered in the last few years, aimed at supplying the EU with Russian gas bypassing Ukraine.[144] The South Stream was the rival project of the EC-backed Nabucco pipeline, aimed at bringing natural gas from the Caspian area to the EU through Turkey.[145]

The EC found that the intergovernmental agreements signed between single MSs and Russia were incompatible with EU law, in that they violated EU rules on unbundling, providing exclusive gas transportation rights to South Stream shareholders.[146] Moreover, they provided for unrestricted transit of Russian gas, violating the EU's third party access rules.[147] The Commissions objections to South Stream ensued, which eventually resulted in Russia aborting the project, depriving EU consumers of a different supply source and prompting criticism from Putin regarding EU energy legislation.[148]

The different views held by Moscow and Brussels with regard to their respective legislation is a source of contention in EU-Russia relations. Russia views its laws on foreign investment as a necessity for the purpose of protecting its strategic industry, which is one of the central pillars of the Russian economy.[149] However, Moscow views the EU's

[144] The project was meant to link the EU with Russian gas bypassing Ukraine through pipelines lying under the Black Sea. For an overview of the project see: <http://www.south-stream-transport.com/project/> accessed 20 August 2016.

[145] The Nabucco pipeline was abandoned in 2013 to favour another project, the Trans-Adriatic Pipeline, currently under construction. See Alexandros Petersen, 'The Nabucco Pipeline Project is Dead' (2011) Oil&Gas Journal <https://www.ogj.com/articles/print/volume-109/issue-45/general-interest/comment-the-nabucco-pipeline .html> accessed 20 August 2016.

[146] Euractiv, 'South Stream Bilateral Deals Breach EU Law, Commission Says' (2013) <http://www.euractiv.com/section/competition/news/south-stream-bilateral-deals-breach-eu-law-commission-says/> accessed 20 August 2016. For an overview of unbundling, see chapter II, section 2.1.

[147] Ibid. For an explanation of third party access rules see chapter II, section 2.2.

[148] Ibid. See Gleb Bryanski, 'Putin Says EU Energy Laws Are Uncivilised 'Robbery'' (2010) <http://in.reuters.com/article/2010/11/26/idINIndia-53174220101126> accessed 1 December 2016.

[149] EUobserver, 'EU and Russia to Sign Trade Memo Amid US Mockery' (2010) <http://euobserver.com/9/31442> accessed 10 September 2016; Euractiv, 'EU Backs Russia's WTO Bid at 'Best Ever Summit'' (2010) <http://www.euractiv.com/en/global-europe/eu-backs-russias-wto-bid-best-ever-summit-news-500397> accessed 10 March 2015.

Third Energy Package as detrimental to the investment climate between the EU and Russia.[150]

Divided views on reciprocal market access have created somewhat of a rift within the EU between old and new Member States, especially those part of the former Soviet Union.[151] This has led to a state of affairs where a compromise is harder to achieve, which in turn has facilitated Russia taking advantage of the lack of a unified stance on the matter.[152]

The EU has much to gain from a united stance towards Russia, given the recurring energy cuts and the protracted negotiations on a revised bilateral agreement, all of which are detrimental to energy cooperation.[153] However, different priorities, historical ties, national loyalty, energy mixes and market positions have resulted in a discord within the EU in its approach towards Russia.[154] The inability of the EU to speak with a single voice is the reason why the EU has failed to develop a coherent strategic approach towards Russia.[155]

Developing a coherent external energy policy depends to a large degree on institutions following general rules rather than cutting individual deals.[156] The Commission, which is in favour of pursuing a common external energy policy, was keen to pave this way when

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[150] Ibid.

[151] Natasha Georgiou and Andrea Rocco (n 91) 248.

[152] Riccardo Alcaro and Emiliano Alessandri, 'Engaging Russia: Prospects for a Long-Term European Security Compact' (2010) 15(1) European Foreign Affairs Review 204.

[153] Kevin Rosner, 'The European Union: On Energy, Disunity' in Gal Luft and Anne Korin, *Energy Security Challenges for the 21st Century* (Greenwood Publishing Group 2009) 166.

[154] Alcaro and Alessandri (n 152) 166.

[155] Leal-Arcas (n 50) 351.

[156] European Commission, 'Energy 2020 A Strategy for Competitive, Sustainable and Secure Energy' COM (2010) 639 final.

launching its 2020 Energy Strategy.[157] EU Member States that prefer to pursue individual barter deals inadvertently enable supplying countries to pursue their own agenda, thus creating a vicious circle, which is hard to break.[158] Inevitably, in order to overcome this practice, it is important that Member States act to the benefit of a collective whole in their bilateral relations with Russia rather than pursuing what is to their exclusive benefit.[159]

However, some Member States have questioned to what extent a common energy policy was truly in their interest. Countries such as France, Germany, UK, Italy and the Netherlands were reluctant to relinquish sovereignty based on their market size and power.[160] Different energy exposures of individual Member States have largely been the obstacle to a strengthened commitment to external EU energy relations.[161] The lack of coherence and unified stance within the EU was apparent in a series of high profile cases, the deal between Gazprom and Germany E.ON Ruhrgas on the Nord Stream being perhaps the most prominent.[162] Indeed, the deal for the construction of the Nord Stream pipeline was seen by some as a deliberate move to bypass traditional transit countries, on a bilateral commercial basis between Germany and Russia, lacking any form of European

[157] Ibid.

[158] Richard Youngs, *Energy Security: Europe's New Foreign Policy Challenge* (Routledge 2009) 82.

[159] European Commission (n 156).

[160] Katinka Barysch, 'Should the Nabucco Pipeline Project Be Shelved?' (2010) Centre for European Reform 4 <http://www.cer.eu/sites/default/files/publications/attachments/pdf/2011/pb_nabucco_5may10-221.pdf> accessed 17 March 2017.

[161] Andrew Macintosh, 'Security of Europe's Gas Supply: EU Vulnerability' (2010) 222 CEPS Policy Brief 2.

[162] Natasha Georgiou and Andrea Rocco (n 91) 248.

solidarity.[163] Today, these controversies are still prominent, with the construction of Nord Stream 2 being a case in point.[164]

## 8. The Impact of Internal Measures at the International Level

In the previous two sections, we outlined the measures adopted by the EU and Russia to regulate their internal energy markets and, indirectly, their energy relationships in the absence of specific international law obligations in the field.

As we will see in chapter IV, the Lisbon Treaty is a turning point of the European energy policy, so that we can distinguish between a pre-Lisbon Treaty and post-Lisbon Treaty approach to the regulation of the EU energy field. The pre-Lisbon approach, outlined in the previous sections of this chapter, is characterised internally by a pervasive regulation of the market aimed at enhancing competition and externally by bilateralism as a default approach of engagement with third countries, which ultimately favoured the adoption by Russia of a divide-and-rule policy towards EU MSs.

With the Lisbon Treaty, the EU radically changed its approach to the energy matters. The new European approach is characterised by the progressive centralisation of the energy competences at the European level and by a primary role of the EU institutions in dealing with energy issues of European relevance. Moreover, since the finalisation of the internal energy market is getting closer, the EU concentrates its efforts on enhancing the security of supply of the Union. For this reason, the Gas Directive, issued in 2009, remains the most important measure regulating the internal energy market.

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[163] Ariel Cohen, 'The North European Gas Pipeline Threatens Europe's Energy Security' (2006) 1980 Backgrounder (Heritage Foundation) <http://www.heritage.org/Research/Europe/bg1980.cfm.> accessed 5 February 2016; Gordon Feller, 'Nord Stream Pipeline Project Stokes Controversy' (2007) 234(3) Pipeline & Gas Journal 92.

[164] For an overview of the project see footnote 36.

Given the current economic scenario, in which the EU is a net importer of gas and Gazprom is its major supplier, the analysis of EU regulation is crucial to evaluate the possible consequences of the internal legal framework on the balance of power between the EU and Russia. Indeed, despite being very strict on foreign companies, Russian internal regulation has not the same economic impact on EU companies. Among the EU measures, as seen above, the Gas Directive is the most relevant piece of internal energy legislation for its impact on foreign companies. The Gas Directive must comply with the international law obligations binding the EU in the energy field. For this reason, it will be analysed in the next chapters of this work.

## 9. Interim Conclusion

This chapter showed the importance of natural gas as an indispensable driver for the present and future economic development of the European Union and sketched out the legal framework applicable to the EU-Russia energy relationship.

From an economic and geopolitical perspective, we underlined that the relationship between the EU and Russia, its most important supplier, is not as unbalanced as one could think. Russia is indispensable for the EU's well-being, and, likewise, the EU is centrally important to the Russian economy. This verified the hypothesis made in the introduction, according to which EU-Russia energy relationship is not only about dependence, but it is characterised also by a high level of interdependence.[165] This strict link entails that any relevant change in the economy, politics or regulation of one has direct effects on the other. This is relevant for our research, focused on the impact of international and internal regulation of EU-Russia energy relations.

[165] See introduction, section 8.

In view of that aim, from a legal perspective this chapter has outlined the international and internal legal framework existing between the EU and Russia which applies to the energy field. In this respect, we have seen that the PCA, the only bilateral agreement in force between the EU and Russia, is not an adequate means to address the complexities typical of the energy field.

In this context, the analysis of the BITs in force between EU MSs and Russia as well as of the applicable customary rules has proven insufficient to shape EU-Russia energy relationships. Only WTO rules seemed to be a suitable international law tool which can be used for the case at hand, since the rules of the GATT and of the GATS are applicable to any kind of energy goods and services traded between the Member States of the organisation. This answers to the first question outlined in the introduction on the actual impact of the current international legal framework on the energy relationships between the EU and its suppliers.[166]

Apart from the international law perspective, we have seen that both the EU and Russia have passed internal regulations which impact on third countries' entities operations in their territories. In case of the EU, the pieces of legislation promulgated focused on the functioning of the internal market, through the issuance of so-called 'energy packages', all-encompassing sets of rules regulating the electricity and natural gas markets. For this reason, the EU external energy action has been characterised by bilateralism of EU members and inconsistencies which favoured a divide-and-rule approach by Russia.

The disjunction in the EU between the 'internal energy policy' and the 'external energy policy', showed in the last sections of this chapter, reflects not only the decentralisation of the matter to MSs but also the absence of a common international legal framework

[166] See introduction, section 8.

outlining the basic principles the parties have to comply with in their reciprocal energy relations. In this way, the security of supply of the Union is left to agreements between private entities subject to market-based mechanisms, which are influenced by the bargaining power of the parties involved. Overall, this approach has proven problematic and could put EU security of supply at risk.

The scope of the next two chapters is the assessment of the main features of the Gas Directive towards WTO rules.

# II

## THE ANALYSIS OF THE MAIN FEATURES OF THE GAS DIRECTIVE

**Summary:** 1. Introduction – 2. Outline of the Main Features of the Gas Directive – 3. The Impact of Article 11 of the Gas Directive on Foreign Investments in the EU – 4. Additional Considerations on Investment Incentives – 5. The Impact of the Gas Directive at the International Level – 6. Interim Conclusion.

### 1. Introduction

In the previous chapter, we outlined the internal and international legal frameworks which impact on the EU-Russia energy relationship. We concluded that, to date, World Trade Organization ('WTO') rules are the only legal tools which at the international level could effectively affect the interdependence of the two countries in the energy sphere. Having said that, WTO rules can be invoked insofar WTO Members want to challenge an internal measure of another Member, which they think could violate WTO rules.

This chapter outlines the main features of Directive 2009/73/EC ('the Gas Directive'), part of the Third Energy Package. For the purposes of this work, we will pay attention to the provisions of the Gas Directive which impact on third countries' undertakings operating in Europe. The Gas Directive is probably the most important natural gas regulation issued before the Lisbon Treaty and certainly the one that impacts the most on third countries' energy interests in the Union. Its provisions, still in force, are the end point of a ten-year evolution of the EU natural gas market regulation. For this reason, we can maintain that the Gas Directive exemplifies the EU's pre-2009 approach to energy which, as we will see in Chapter IV, radically changed with the adoption of the Lisbon Treaty.

The overview presented in this chapter will be then used to open up several questions on the compatibility of the European measures with WTO obligations binding the EU, which

will be analysed in the next chapter of this work, and answer to the second question outlined in the introduction of this work.[1]

## 2. Outline of the Main Features of the Gas Directive

The next sections give background information on the main concepts of the Gas Directive which impact on third countries' companies operating in the EU: unbundling, third party access and the so-called 'third country clause'. The following sections are not to be intended as a complete analysis of the issues described therein, but only as a framework to understand the next chapters of the thesis.

### 2.1 Unbundling

The word 'unbundling' is typically used in relation to the liberalisation of markets in which companies provide their services through a natural monopoly, which most commonly consists of a network of pipelines or cables.[2] The term, meaning separation, is referred to the degree of independence granted to the sections of the supply chain dealing with the management and operation of a natural monopoly.[3]

[1] The question outlined in the introduction is the following: Is the EU intervention in the natural gas field compliant with the international law rules binding the Union in the field?

[2] According to Court of Justice of the European Union's case-law 'the expression essential facility is used to describe a facility or infrastructure which is essential for reaching customers and/or enabling competitors to carry on their business and which cannot be replicated by any reasonable mean' (notice on the application of the competition rules to access agreements in the telecommunication sector, OJ 1998 C265/2, para 68).

[3] Ernst von Weizsacker, Matthias Finger, Marianne Beisheim and Oran Young, *Limits to Privatization* (Routledge 2012). For a description of the traditional corporate structure of the undertakings operating in the energy sector, please refer to Mette Bjorndal, *Energy, Natural Resources and Environmental Economics* (Springer 2010) 434; Raffaele Fiocco, 'The Desing of Industry Structure in a Vertically Related Market' (2007) IEFE Working Paper 1/2007 <https://www.researchgate.net/publication/228268846_The_Design_of_Industry_Structure_in_a_Vertically_Related_Market> accessed 4 July 2014; and Edward Mitchell, 'Vertical Integration in the Oil Industry' (1976) American Enterprise Institute for Public Policy Research.

A monopoly is 'natural' when, because of physical constraints, the construction and operation of a good or of a service cannot be carried out by more than a single entity.[4] The opposite solution would lead to three problems: the need to fund the enormous construction costs required to replicate the infrastructure; the decreasing effectiveness of its duplication; the sub-optimal utilisation of the assets built.[5] There are examples of natural monopolies in several markets: telecommunication fixed networks, electricity networks, gas pipelines and railways.[6]

In an unregulated scenario, a natural monopoly leads to the situation in which a single operator is present in the relevant market, no competition is established, and, because of that, the monopolistic operator could set prices and conditions of use of the natural monopoly at will, diminishing aggregate consumer welfare. In order to prevent these drawbacks, the European legislator introduced the concepts of unbundling and third party access ('TPA') and enhanced the role of national regulatory authorities ('NRAs').[7]

In the Third Energy Package, unbundling relates to the transportation and distribution activities operated by players of the natural gas and electricity markets. Transportation and distribution in these fields are carried out either by means of long pipelines departing from the production countries to reach final customers (in the case of natural gas) or through a high voltage network (in case of electricity). Generally, transportation and

[4] Baumol provided the definition of a 'natural monopoly': '[a]n industry in which multi-firm production is more expensive than production by a monopoly'. See William J Baumol, John C Panzar and Robert D Willig, *Contestable Markets and the Theory of Industry Structure* (Harcourt Brace 1982) 810.

[5] For a complete economic analysis of the reasons behind these issues, read the Nobel Prize winner Robert Solow, *Monopolistic Competition and Macroeconomic Theory* (CUP 2010).

[6] For the analysis of natural monopolies regulatory measures see Jose Gomez-Ibanez, *Regulating Infrastructures* (HUP 2003); Richard Posner, *Natural Monopoly and Its Regulation* (Cato Institute 1999); Stephen Davies, Nigel Driffield and Roger Clarke, *Monopoly Policy in the UK: Assessing the Evidence* (EE 1998); Sanford Berg and John Tschirhart, *Natural Monopoly Regulation: Principles and Practice* (CUP 1988).

[7] See section 2.2 below.

distribution activities vary based on the characteristics which influence the power capacity of the pipeline or of the network concerned (such as the size and the pressure in case of gas, or voltage in case of electricity).[8]

Historically, transportation and distribution activities were carried out by the same companies dealing with production (if any) and supply of natural gas or electricity to final customers. These market players – 'incumbents' – because of their operation in all the sections of the supply chain are also called 'vertically integrated companies' (see figure 3 below as regards natural gas).[9]

Figure 3: Structure of the Natural Gas Industry (Source: DTE Energy)

[8] Pursuant to Article 2 of the Gas Directive, 'transmission' means 'the transport of natural gas through a network, which mainly contains high-pressure pipelines, other than an upstream pipeline network and other than the part of high-pressure pipelines primarily used in the context of local distribution of natural gas, with a view to its delivery to customers, but not including supply'. Under the Gas Directive, 'distribution' is defined as the 'transport of natural gas through local or regional pipeline networks with a view to its delivery to customers, but not including supply'. According to Investopedia, 'midstream activities include the processing, storing, transporting and marketing of oil, natural gas and natural gas liquids'. 'Downstream operations can include refining crude oil and distributing its byproducts — such as gasoline, natural gas liquids, diesel and a variety of other energy sources — down to the retail level. The closer an oil and gas company is to the process of providing consumers with petroleum products, the further downstream the company is said to be'. See <https://www.investopedia.com/terms/m/midstream.asp> and <https://www.investopedia.com/ terms/d/downstream.asp> accessed 15 April 2017.

[9] Pursuant to Article 2 of the Gas Directive, a vertically integrated undertaking 'means a natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas'.

Over the years, the efforts put in place by the European Union to enhance competition, seen as the main tool to achieve an effective European energy market,[10] led to the increasingly stronger application of unbundling rules. In fact, one of the purposes of the Gas Directive is to strengthen the separation models implemented by the Second Energy Package, which, in turn, were more effective than the mild provisions of Directive 98/30/EC. To do so, the Gas Directive sets out three unbundling models from which EU Member States ('MSs') have to choose, that mainly differ in relation to the ownership and the management of the companies dealing with the natural monopoly.

The three alternatives proposed by the European legislation are: (i) complete ownership unbundling; (ii) Independent Transmission Operator ('ITO'); and (iii) Independent System Operator ('ISO').[11] The Gas Directive applies these models only to the companies operating in the transportation sector. The Gas Directive sets out a lighter separation scheme for distribution activities, modelled on the basis of the ITO system, which allows the vertically integrated company to retain the property of the infrastructure, provided that certain minimum characteristics of independence are met.[12] The distinction made between transportation and distribution is a consequence of the different number and importance of the operators present in the market, of the relative unbundling costs and of the possible impact of their anticompetitive activities.

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[10] Richard Whish and David Bailey, *Competition Law* (7th edn, OUP 2012) 23-24, where the achievement of the single market is described as an 'imperative' of the EU institutions. Under Article 26 of the Lisbon Treaty 'the Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market'.

[11] Gas Directive, Art 9 (ownership unbundling), Art 17 (ITO), Art 14 (ISO). See also Caroline Kuzemko, Andrei V Belyi, Andreas Goldthau and Michael Keating, *Governance in Europe and Russia* (Palgrave Macmillan 2012) 233-234.

[12] Gas Directive, Art 26. For the definition of distribution see footnote 8.

### *2.1.1 Ownership Unbundling*

The first unbundling model, set out under Article 9 of the Gas Directive, provides for the complete separation of the ownership of transportation activities from production and supply. Ownership unbundling requires vertically integrated undertakings to sell the stakes they hold in the transportation companies ('TSOs') which operate in the countries that adopt this unbundling model.

In the context of Article 9, the definition of 'control' is a key element. The Gas Directive does not prevent gas producers or suppliers from holding participations in European TSOs; it only requires that the participations held do not amount to a share allowing the 'control' the relevant TSO.

The definition of 'control' under the Gas Directive has to be interpreted broadly, in conformity with the EU Merger Regulation.[13] This latter outlines that:

> control shall be constituted by rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking.[14]

In particular, the Merger Regulation acknowledges the presence of a decisive influence on a company by way of ownership of assets (or right to use them) or in powers over the make-up or decision making of the board of directors or equivalent managing body.[15]

[13] Gas Directive, recital 10. See Council Regulation 139/2004/EC on the Control of Concentrations between Undertakings [2004] OJ L24/1 (the 'Merger Regulation') and European Commission, 'Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: the Unbundling Regime' (2009) 8 <http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/implementation_notes/2010_01_21_the_unbundling_regime.pdf> accessed 6 January 2014.

[14] Merger Regulation, Article 3.

Remarkably, control means both in law and in fact, and also includes indirect control – through subsidiaries – and the so-called 'negative control', whereby minority shareholders enjoy veto rights on strategic decisions of the company concerning budget, appointment of management, investments and business planning.[16]

Particularly noteworthy is the fact that ownership unbundling is extended throughout the whole EU common market. This means that, to take one example, a producer in the Dutch market cannot control a company dealing with transportation activities in France.

Lastly, the ownership unbundling regime requires EU Members to ensure that neither commercially sensitive information held, nor the staff of a transmission system operator which was part of a vertically integrated undertaking is transferred to undertakings performing any of the functions of production and supply.[17]

*2.1.2 Independent Transmission Operator*

The second model proposed by the Gas Directive, ITO,[18] has been defined by some commentators as a sort of potentiated functional unbundling, which was introduced in the Second Energy Package.[19] This type of unbundling allows the vertically integrated

[15] In this respect, Article 9(1)(c) specifies that 'the same person or persons are not entitled to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking, of a transmission system operator or a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of production or supply'; and Article 9(1)(d) outlines that 'the same person is not entitled to be a member of the supervisory board, the administrative board or bodies legally representing the undertaking, of both an undertaking performing any of the functions of production or supply and a transmission system operator or a transmission system'. See also Linklaters LLP, 'Europe's Third Energy Package: Unbundling' (2011) <http://www.linklaters.com/Publications/Thirdenergypackage/Pages/Index.aspx> accessed 18 October 2013.

[16] Ibid.

[17] Gas Directive, art 9(7).

[18] Gas Directive, art 17-23.

[19] See Michael Diathesopoulos, *From Energy Sector Inquiry to Recent Antitrust Decisions in European Energy Markets, Competition Law as a Mean to Implement Sector Regulation* (CUP 2010) 4.

company to retain the ownership of the TSO. However, it requires the adoption of specific corporate governance policies to guarantee TSO's autonomy and independence.

In particular, the ITO model requires a clear-cut distinction between the TSO activities and those of the rest of the group operating in the same market. The ITO must not generate confusion – not only in the eyes of NRAs, but also in the eyes of the end-consumers – with the rest of the vertically integrated undertaking in its corporate identity, communication, branding and premises.[20]

Moreover, the Gas Directive dictates that the ITO shall own the network and any other asset necessary for the transportation activities, and that it is not allowed to share IT systems and equipment, physical premises or security access systems with any other part of the vertically integrated undertaking.[21] These restrictions are reinforced with the prohibition of using the same consultants or external contractors for IT systems or equipment, security access systems or auditing.[22]

Furthermore, to enhance the independence of the ITO and to guarantee the development of the network, the Gas Directive sets out that the ITO shall be funded with adequate financial resources by the incumbent.[23] In any event, the ITO may also gather the financial resources needed directly on the market (e.g. through the issuance of corporate bonds).[24] In this way, the ITO model completely detaches the TSO from the investment and the budgetary decisions of the mother company.

[20] Gas Directive, art 17(4).

[21] Ibid 17(5).

[22] Ibid 17(6).

[23] Ibid 17(1).

[24] Ibid 18(1).

Last but not least, to prevent any possible residual influence by the former incumbent, the Gas Directive mandates the adoption of a compliance plan and the setup of a supervisory body.[25] The former, to be approved by the relevant NRA, contains specific provisions to preserve the independence of the ITO and prevent the risk of discrimination between final customers. The supervisory body, natural or juridical person appointed by the supervisory board of the TSO with the approval of the relevant NRA, is a subject provided with the vastest power of vigilance. The supervisory body proceeds independently to the verification of the correspondence of the ITO decisions to the compliance plan and refers the possible deviations to the relevant NRA.

*2.1.3 Independent System Operator*

The third model outlined in the Gas Directive, ISO,[26] is a hybrid solution between the ITO and the ownership unbundling.[27] On the one hand, as in the ITO model, the ISO allows the former incumbent to retain the property of the transportation activities. On the other hand, as in the ownership unbundling model, the ISO requires the management of the natural monopoly to be carried out by a different (and independent) entity to guarantee the non-discrimination between the users of the infrastructure.[28]

The ISO has to be certified by the national regulatory authority and receive the approval of the European Commission.[29] The appointed subject shall demonstrate, *inter alia*,

[25] Ibid 18(4).

[26] Ibid Arts 13 and 14.

[27] Some commentators pointed out that, in reality, there is no difference between the ITO and the ISO models. See Biancardi, currently member of the Italian Authority for Electric Energy and Gas, in AREL – Agenzia di Ricerche e Legislazione, *Il Recepimento del Terzo Pacchetto Comunitario: Un'Opportunità per il Settore del Gas Naturale Italiano?* (AREL 2010).

[28] Gas Directive, art 14.

[29] Ibid 14(1).

adequate financial, technical, physical and human resources to carry out the management of the infrastructure, as well as the capacity to comply with the obligations placed upon it by the Gas Directive.[30] Among the others, it is relevant to underline that the ISO is exclusively responsible for ensuring the long-term ability of the system to meet reasonable energy demand through investment planning.

Within this framework, the owner of the infrastructure is compelled to operate in a way to ensure that the ISO can fulfil its duties. This requires the financing of the ISO's network development plan and scheduled investments, as well as the compliance with the obligation to provide the necessary insurance policies to protect from damages unrelated to the management of the network.[31]

*2.1.4 Concluding Remarks on Unbundling*

EU Members have to choose one unbundling model out of the three options described above to implement the Gas Directive in their territory. That said, in any event, their choice could be limited by other applicable provisions of the Gas Directive.

Pursuant to Article 9(8) of the Gas Directive, the applicability of the ITO and ISO models is limited to MSs' companies which, on 3 September 2009, are part of a vertically-integrated undertaking. After that moment, new TSOs have to apply the ownership unbundling regime.[32]

[30] Ibid 14(5).

[31] Ibid 14(5).

[32] European Commission, 'Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: The Unbundling Regime' (2010) Commission Staff Working Paper <http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/implementation_notes/2010_01_21_the_unbundling_regime.pdf> accessed 24 October 2013.

Article 9(8) reveals that, in the eyes of the European legislator, ITO and ISO are mere second-best options. This is evident also when analysing the Gas Directive's preparatory works where, on the basis of the evidence provided by the Energy Sector Inquiry, the European Commission ('EC') strongly supported the adoption of the sole ownership unbundling model, in line with the solutions put forward in the antitrust cases opened between 2007 and 2010.[33] The milder scheme adopted in the final text is the result of the

[33] For an analysis of the preparatory works of the Gas Directive see Victor Von Hoorn, ''Unbundling', 'Reciprocity' and the European Internal Energy Market: WTO Consistency and Broader Implications for Europe' (2009) 18 European Energy and Environmental Law Review 58; Spencer Gilbert, 'Gas Politics in Russia and the EU' (2009) <http://www.nyu.edu/clubs/jpia.club/PDF/S09_Gilbert.pdf> accessed 24 November 2013. Between 2007 and 2010 the European Commission, through its Directorate General for Competition, opened up several proceedings against the major European natural gas incumbents for the breach of Articles 101 and 102 TFEU (former Articles 81 and 82 TEC): *Commission v RWE* (Case COMP/39.402) [2009] OJ C133; *Commission v E-ON* (Case COMP/39.388) [2009] OJ C36; *Commission v Gaz de France* (Case COMP/39.316) [2010] OJ C57; *Commission v ENI* (Case COMP/39.315) [2010] OJ C352. The behaviours put under investigation by the European officials in the course of EC's three-year action can be classified in three main categories: exclusionary abuses, exploitative abuses and market partitioning. The European antitrust enforcement deeply influenced the structure of the undertakings involved. Among the others, the cases RWE Gas Foreclosure and ENI Gas Foreclosure exemplify the pro-competitive attitude of the Commission during that period. These cases have been closed with the EC's acceptance of burdensome commitments proposed by the undertakings under investigation, consisting in the sale of the pipelines concerned. The analysis of these commitments is relevant because they are examples of so-called 'ownership unbundling' remedies (see chapter II, section 2.1). Noteworthy, their adoption witnesses the EC's preference for the separation of the ownership of the transportation activities from the other sections of the natural gas supply chain. This preference was reflected also in the preparatory works of the Gas Directive. Michael Diathesopoulos in 'From Energy Sector Inquiry to Recent Antitrust Decisions in European Energy Markets, Competition Law as a Mean to Implement Sector Regulation' (2010) 11 <https://ssrn.com/abstract=1639883> accessed 17 May 2017, reports the ways in which a gas transportation company could use the essential facility to take advantage for itself or its affiliated companies. In particular, the author lists: margin squeeze, inadequate capacity management, capacity hoarding and degradation, long-term capacity bookings by the incumbent shipper and strategic limitation of the investments. The CJEU identifies an abusive behaviour only in case of danger for the competition level existing inside the market or whenever the behaviour hampers the correct development of the market (See Case T41/96, *Bayer v Commission* [2000] ECR II3383 and Case C-241/91, *Magill v Commission* [1995] ECR I-743). This reasoning is valid also in case of the third party access discipline. In *Oscar Bronner v Commission* the Court has defined three cumulative criteria which are necessary to recognise the obligation to grant access to the facility. According to the Court, in order to be censored, the decision of the owner not to grant access to third parties to the natural monopoly should have the following characteristics: It should be adequate to completely eliminate the competition in the sector where the requesting undertaking operates; it should not be justified by objective reasons; and the requested utilisation should be indispensable for the requesting company to conduct its business operation. One of the hot topics of the Commission work along the years has been the analysis of the competition constraints due by the presence of long-term gas purchasing contracts. For a complete overview, please refer to Aldo Spanjer, 'Long-term Contracts and Competition on European Gas Markets – Has the Commission Struck the Right Balance*?'* (2009) 10 Competition & Regulation in Network Industries 189.

harsh debates that took place during the preparatory stages, where MSs, lobbied by their national champions, supported more conservative solutions.[34]

Lastly, it is useful to make some remarks about the scope of the application of the unbundling rules. Article 9 obligations are wide enough to cover both the natural gas and the electricity sectors. Pursuant to Article 9(3), no natural gas company, public or private, dealing with production or supply of gas, can control other companies dealing with the transmission of electricity in the internal market. The opposite is also true: pursuant to Article 9 of Directive 2009/72/EC, part of the Third Energy Package and regulating the electricity market, this obligation applies also in respect to electricity producers or suppliers operating in the natural gas sector.[35] This reflects the unitary approach of the European legislator *vis-à-vis* electricity and natural gas, considered to be parts of the same market.

### 2.2 Third Party Access

Third party access is, together with unbundling, the backbone of the European pro-competitive regulation of the energy sector.[36]

In brief, third party access is the obligation imposed upon the owner and/or manager of a natural monopoly to grant access on a non-discriminatory basis to all users requesting it.

[34] Michael Hunt, 'Ownership Unbundling: The Main Legal Issues in a Controversial Debate' in Bram Delvaux, Michael Hunt and Kim Talus, *EU Energy Law and Policy Issues* (Intersentia 2014); Simon Taylor, 'France and Germany Lead Unbundling Opposition' (2007) European Voice <http://www.europeanvoice.com/article/imported/france-and-germany-lead-unbundling-opposition/58045.aspx> accessed 22 November 2013.

[35] European Parliament and European Council Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive2003/54/EC [2009] OJ L211, Art 9(3).

[36] Third party access has been introduced in the EU legislation in the second energy package. See European Parliament and European Council Directive 2003/55/EC of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L176.

This obligation has been progressively expanded in each energy package, and it is now included under Article 32 of the Gas Directive.

The need to grant access on an equal footing to the infrastructure to any subject requesting it is fundamental to create a 'level playing field' which enables competitors to freely conduct their business all around Europe.[37] This, in turn, is crucial to enhance the welfare of final customers who, as the economic theory of competitive markets suggests, benefit from lower prices and better quality of the service when competition is increased in the market.

In particular, the Gas Directive requires Member States to guarantee the application of a TPA system based on regulated tariffs approved by NRAs, applied objectively and without discrimination between the users.[38]

### 2.3 Third Country Clause

Article 11 of the Gas Directive is one of the most important and, at the same time, also one of the most controversial provisions of the Third Energy Package. Its analysis is crucial when evaluating the position of foreign investors operating in the common market, as well as the intertwined geopolitical implications emerging from the relationships between the Union and third countries.

[37] Alexander Kotlowsky, 'Access Rights to European Energy Networks – a Construction Site Revisited' in Delvaux, Hunt and Talus (n 34) underlines that 'the third party access right should be considered to be a right that accompanies an energy contract. It should not be seen as a right that allows traders to reserve and trade 'network capacity' in the incumbent's infrastructure without an underlying sales contract'.

[38] On third party access applied to storage sites see Anton Gao, 'The Third European Energy Liberalisation Package: Does Functional Unbundling in the Gas Storage Sector Go Too Far?' (2008) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1167793> accessed 22 November 2013.

Essentially, this clause sets out the applicability of the unbundling provisions of the Gas Directive to third countries' entities operating in Europe.[39] This has significant implications for Gazprom (thus the provision has been famously dubbed 'Gazprom clause'). In particular, Article 11 stipulates that NRAs shall refuse to issue the certification required to operate in the natural gas market whenever requested by an owner or a manager of a TSO which is controlled by one or more subjects of a third country. To avoid that, the requesting company should demonstrate that (i) it complies with the unbundling rules of Article 9; and (ii) the issuance of the certification would not jeopardize the security of supply of the Member State where the company operates – or is willing to operate – and the security of supply of the Union as a whole.[40]

To evaluate the risks related to the security of supply, the NRA must analyse, *inter alia*, the rights and the obligations of the EU in relation to third countries arising from

[39] Gas Directive, art 11(3). See Andrey Konoplyanik, 'Energy Investment in the EU and Russia: Investment Regulation under the Third Energy Package and the Russian Law on Foreign Investments in Strategic Sectors' (2013) First Groningen-Moscow Conference on EU-Russian Energy Law, 30-31 May 2013 <http://www.konoplyanik.ru/speeches/130531-Konoplyanik-Groningen-investment.pdf> accessed 17 July 2017; Andrey Konoplyanik, 'The EU Versus Gazprom' (2012) 372 Energy Economist 3; Andrey Konoplyanik, 'The Third Energy Package and the Concerns of Non-EU Gas Producers: An Interview with Dr. Andrey Konoplyanik' (2012) <http://www.eurasia-energy-observer.com/news/new/interview-with-andrey-konoplyanik> accessed 27 October 2013; Philip Lowe, Ingrida Pucinskaite, William Webster and Patrick Lindberg, 'Effective Unbundling of Energy Transmission Networks: Lessons from the Energy Sector Inquiry' (2007) 1 Competition Policy Newsletter 23.

[40] In particular, Article 11(3) of the Gas Directive states that 'The regulatory authority shall adopt a draft decision on the certification of a transmission system operator within four months from the date of notification by the transmission system operator. It shall refuse the certification if it has not been demonstrated: (a) that the entity concerned complies with the requirements of Article 9; and (b) to the regulatory authority or to another competent authority designated by the Member State that granting certification will not put at risk the security of energy supply of the Member State and the Community. In considering that question, the regulatory authority or other competent authority so designated shall take into account: (i) the rights and obligations of the Community with respect to that third country arising under international law, including any agreement concluded with one or more third countries to which the Community is a party and which addresses the issues of security of energy supply; (ii) the rights and obligations of the Member State with respect to that third country arising under agreements concluded with it, insofar as they are in compliance with Community law; and (iii) other specific facts and circumstances of the case and the third country concerned'.

international law (first and foremost, the treaties in force between the Union and the home country of the requesting entity), as well as the specific circumstances of the case.[41]

We can identify two aspects in the provision at hand. The first one relates to the corporate structure requirements of item (i) above, mandating the application of the unbundling rules of Article 9. These equally apply to each and every undertaking (EU and non-EU) and reflect the EU's right to regulate the entities operating in the internal market. The second, and more problematic, aspect is the evaluation process to be carried out by the competent regulatory authority under item (ii). This seems to be an activity which could unjustly discriminate between competitors.

Indeed, the first criterion to be taken into account under item (ii) (i.e. the international agreements in place between the EU and the home country of the undertakings concerned) *de facto* discriminates between third countries' entities operating in the EU on the basis of something which is not under their control. In fact, the conclusion of international agreements depends only on the political will of the EU and the third country where the undertaking concerned originates. As for the second and last criterion to be used for the NRAs' assessment, the circumstances of the case vary on the basis of the subject requesting the certification, the timing of the request and other possible contingencies.[42]

[41] Gas Directive, art 11(3)(b).

[42] For example, in the context of Nord Stream construction, the OPAL pipeline (allowing natural gas to flow from Nord Stream to the Czech Republic via Germany) obtained a partial exemption of its capacity for 22 years. 50% of the capacity of OPAL is currently allocated on the basis of third party access rules, while the other 50% can be freely used according to the rules set out in sponsor's private agreements. However, the exemption requested by the sponsors was for 80% of the total pipeline capacity. In the context of the Trans-Adriatic Pipeline exemption request, the unclear procedures adopted by the European Commission and the Italian NRA pushed the Italian Senate to ask formal clarification to the Ministry of Economic Development. See <http://www.senato.it/japp/bgt/showdoc/showText?tipodoc=Sindisp&.leg=17&id=1000537> accessed 29 April 2017.

Hence, Article 11 does not guarantee that the same approach would be used to evaluate different situations and subjects.

The rules described above apply, and notification is required, whenever there is a change of control by which a non-EU entity takes the control of a European TSO.[43] In any event, the NRA concerned must notify the European Commission of the change of control, as well as of the final decision it takes.[44] When requested by the relevant NRA, the EC shall evaluate the circumstances of the case and formulate advice, which must be considered in the NRA's assessment.[45]

Notwithstanding to the above, the Member State where these companies are going to operate could in any event 'refuse certification where granting certification puts at risk the Member State's security of energy supply or the security of energy supply of another Member State'.[46] This safeguard clause, which echoes the security exceptions under Article XIV-bis GATS (see chapter III, section 7), leaves a wide discretion open for a Member State to act. In fact, no indication is set about the limits and the modalities to exercise this power. Moreover, in case of third countries' entities the Gas Directive expressly recalls the MSs right to 'exercise, in compliance with Community law, national legal controls to protect legitimate public security interests'.[47] This clause seems to further underline the autonomy granted to EU MSs towards foreign companies investing in their territories.

[43] Ibid, art 9(3).

[44] Ibid, art 9(4).

[45] Ibid, art 11(8).

[46] Ibid.

[47] Ibid 11(9).

## 3. The Impact of Article 11 of the Gas Directive on Foreign Investments in the EU

Article 11 is the cornerstone provision to evaluate the impact of the Gas Directive on foreign entities. As seen in the previous sections, this expands the unbundling obligations under Article 9 not directly to third States, but towards third countries' companies operating in the European market.

Chapter I showed that the EU relies to a considerable extent on third countries, namely Russia, Algeria, Libya, Norway and Qatar, to satisfy its internal natural gas demand.[48] These countries generally manage the supply of their natural resources through vertically integrated state-controlled entities which, over the years, have made considerable investments to cope with the European gas demand. This particularly holds true for Gazprom,[49] which, also for historical reasons linked to the development of the first pipelines supplying Europe, maintains a tremendous market power in former Soviet Union countries.[50]

By imposing on third countries' controlled companies the compliance with the unbundling rules and the respect of additional certification requirements, Article 11 could have negative economic consequences on the undertakings concerned. Damage flowing from the loss of secured revenues (given the widespread application of standard prices for transportation services which lower the return on investment rates and extend the

[48] See chapter I, section 2.

[49] For an in-depth description of the position of the company in the European market, refer to chapter I, section 3. To take an example, the cumulated costs for the construction of the Nord Stream and of the Nord Stream 2, both sponsored by Gazprom, amount to 19 billion Euros.

[50] To date Gazprom still owns shares in several EU TSOs: 25% of Gasum Oy (Finland); 34% of Latvijas Gaze (Latvia), 48% of EuRoPol (Lithuania and Poland), and extended its presence in other projects of European interest (*e.g.* North Stream and Nord Stream 2 pipelines).

amortisation periods of the single projects) and from the unbundling application, would be added to other harmful elements such as a transaction costs increase and possible trade volume variations.[51] This could end up imposing a *de facto* roadblock to the public policy objectives of the affected States.[52]

Article 9(12) of the Gas Directive states that undertakings operating in the production or supply of gas cannot 'in any event be able to directly or indirectly take control over or exercise any right over unbundled transmission system operators in Member States which apply paragraph 1 [the ownership unbundling model]'. This means that third countries' companies that produce and supply gas would no longer be permitted to be or to control a TSO in a Member State which adopts the ownership unbundling model.[53] This obligation is particularly burdensome for investors that have already bought a stake in TSOs in the countries adopting the ownership unbundling. With ownership unbundling and third country clause, these companies will either need to sell their stakes in certain TSOs or take the risk that these TSOs will no longer be permitted to operate in the EU.[54] This is what happened in Lithuania where, following the decision of the government to adopt the ownership unbundling regime, Gazprom and E.ON, major stakeholders of the Lithuanian natural gas incumbent Lietuvos Dujos, were forced to sell at least the part of their stakes (37% and 39% respectively) which had allowed them to 'control' the Lithuanian undertaking.[55] Pursuant to Article 9(8) of the Gas Directive, new TSOs and

[51] See section 4.

[52] Think for example, the impact of Gazprom on Russia's GDP, illustrated in chapter I, section 3.

[53] Arnoud Willems, Jung-ui Sul and Yohan Benizri, 'Unbundling as a Defence Mechanism against Russia: Is the EU Missing the Point?' (2009) 1 Oil Gas and Energy Law Journal.

[54] Ibid 2.

[55] Gazprom faced the same situation with Eesti Gaas, the Estonian incumbent, which was obliged to adopt the ownership unbundling model following the issuance of the 2012 Natural Gas Act.

networks built after the entry into force of the Gas Directive have to be separated from any company producing or supplying natural gas. This rule is particularly relevant in relation to interconnection projects with supplying countries, whose construction has been considered essential since the Energy Sector Inquiry.[56]

Clearly, the measures described may have a negative impact on the promotion of transnational infrastructure investments, pushing potential investors to adopt different strategies aimed at the diversification of their investments in infrastructure in the long-term.[57] What is even more important is that, in the short-term, these legislative manoeuvres could even put at stake the security of supply of the EU,[58] above all in countries which, for historic and geographical reasons, are more dependent on third countries' gas. Remarkably, this attitude could in the end go against the policy objectives of the EU, because ensuring a long-term security of supply is one of the purposes of the European legislator, as well as one of the reasons for the adoption of the Gas Directive.

[56] European Commission, 'DG Competition Report on Energy Sector Inquiry' SEC (2006) 1724, paras 16, 58 and 84.

[57] For example, on May 21, 2014, Gazprom and China National Petroleum Corporation signed a purchase and sale agreement to supply Russian gas via the Eastern route. This is the biggest purchase and sale contract in the history of the global gas industry (delivering 38 bcm of natural gas annually to China). The partnership between Russia and China in the sphere of natural gas recently stepped up to a completely new level because of the Chinese will to use less polluting energy sources (see chapter I, section 2) and the Russian desire to diversify its demand-side. In 2019, the first volumes of Russian pipeline gas will be delivered to China. See also Andrey Konoplyanik, 'How is Russia's Gas Export Strategy Evolving and Why Will It Work for Russia?' (2016) Oil, Gas & Energy Law Journal, 4 <https://www.ogel.org/article.asp?key=3653> accessed 27 December 2016.

[58] This was one of the reasons justifying the adoption of the liberalisation directives. In the Gas Directive this is underlined in *considerandum* No. 1, 21, 22 (where security of supply is described as 'an essential element of public security and is therefore inherently connected to the efficient functioning of the internal market in gas and the integration of the isolated gas markets of Member States') 40, 44, 47 and 55. The problems regarding investment incentives have been at the basis of some of the antitrust investigations led by the Commission in the 2007-2010 period. In particular, companies were charged by the EC of 'strategic underinvestment' as a way to create barriers to entry to new competitors in the market. For a deeper analysis of this topic, please refer to Ulrich Sholtz and Stephan Purps, 'The Application of EC Competition Law in the Energy Sector' (2010) 1 Journal of European Competition Law & Practice 45.

Furthermore, we must underline that it is not crystal-clear whether Article 11 is meant to extend the European unbundling rules inside third countries' territory. Even though the Gas Directive does not explicitly state it, this eventuality has been supported by Professor Konoplyanik, former deputy secretary General of the Energy Charter Secretariat, and one of the most renowned Russian energy experts.[59] Undoubtedly, that was the initial attitude of the EC, which, along with the support of the ownership unbundling model inside the single market, expressed the desire to 'export' the same scheme in third supplying countries.[60] In this sense, Mr. Lowe, the former EC director general for energy, together with the Directorate General for Competition's officials Mrs. Pucinskaite, Mr. Webster and Mr. Lindberg stated that:

> whilst there is considerable scope to reflect about options about how to best implement ownership unbundling, it should be clear from the outset that companies which are actual or potential suppliers in a given Member State could not acquire/maintain networks in this Member State. This also applies to companies located outside the EU.[61]

[59] Andrey Konoplyanik, 'The Third Energy Package and the Concerns of Non-EU Gas Producers: An Interview with Dr. Andrey Konoplyanik' (2012) <http://www.eurasia-energy-observer.com/news/new/interview-with-andrey-konoplyanik> accessed 27 October 2013; Andrey Konoplyanik, 'Russia and the Third Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Including Non-EU Suppliers) and Consumers' (2011) 8 International Energy Law Review 24; Alexander Jouravlev, 'The Effect of the European Union's Unbundling Provisions on the EU-Russian Natural Gas Relationships and Russia's Accession to the World Trade Organization' (2011) 17 <http://www.ssrn.com/abstract=196 9502> accessed 20 October 2013.

[60] See *considerandum* No. 21 of the Gas Directive, where the European legislator states that 'fully effective separation of network activities from supply and production activities should apply throughout the Community to both Community and non-Community undertakings'.

[61] Philip Lowe, Ingrida Pucinskaite, William Webster and Patrick Lindberg, 'Effective Unbundling of energy Transmission Networks: Lessons from the Energy Sector Inquiry' (2007) 1 Competition Policy Newsletter 28.

This view is supported also by the preparatory works of the Gas Directive, which set out an express reciprocity clause aimed at the application of the European unbundling measures inside third countries.[62]

In the opinion of the writer, we can still support the extraterritorial application of Article 11 focusing on the definition of 'vertically integrated undertaking' of the Gas Directive.[63] This is wide enough to include all the companies that are part of the same group (covering also those incorporated under third countries' law), by treating them as a single entity. This view reflects the traditional approach of the Court of Justice of the European Union case-law concerning competition matters, according to which the extensive interpretation of the word 'undertaking' and the concept of 'group of companies' overlap (so-called 'economic entity doctrine').[64]

Because of the all-encompassing definition of vertically-integrated undertaking under EU law, one could argue that the unbundling obligations of the Gas Directive should be extended not only in relation to companies operating in EU MSs, but also to all the other undertakings that are part of the same group, even if incorporated in third countries.

This view seems to be reinforced by a Commission's report,[65] which outlines that, in the context of the analysis of the ITO model, the Commission:

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[62] Von Hoorn (n 33) 58; Gilbert (n 33).

[63] Pursuant to Article 2 of the Gas Directive ''vertically integrated undertaking' means a natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas'.

[64] Case C-97/08 *Akzo Nobel NV and Others v Commission* [2008] ECR II-5049. See Richard Whish and David Bailey, *Competition Law* (8th edn, OUP 2015) 95.

[65] European Commission, 'Commission Opinion of XXX Pursuant to Article 3(1) Of Regulation (EC) No 715/2009 and Article 10 of Directive 2009/73/EC – Germany – Certification of the Operators of the Nordeuropäische Erdgas-Leitung (NEL)' (2013) <http://ec.europa.eu/energy/gas_electricity /interpretative_notes/doc/certification/2013_083_ 084_085 _de_en.pdf> accessed 3 December 2013.

> is of the opinion that the rules of the ITO that relate to the vertically integrated undertaking ['VIU'] are applicable to all the companies within the group the VIU, irrespective of whether they carry out themselves activities related to supply or generation of gas or electricity.

In line with this aim, the EC 'argues that the scope of the VIU should not be restricted geographically'.[66] For the EC, the third country companies involved have to be 'considered part of the VIU and thus obliged to comply with the rules applicable to VIUs, as laid down in Chapter IV of the Gas Directive [on ITO implementation]'.[67]

In principle, third countries could not rely on Article 9(8) (opt for an ISO or ITO model) to comply with unbundling obligations of the Gas Directive because, according to the same paragraph, ISO and ITO models can only be adopted by 'the Member State concerned'.[68] Therefore, as a logical consequence it would appear that ownership unbundling would be the only model applicable to comply with the provisions of the Gas Directive inside third states' territories.

## 4. Additional Considerations on Investment Incentives

In the previous section, we have highlighted the legal constraints set out in the wording of the Gas Directive which impact on foreign investors. In addition to that, it is worth noting that the Gas Directive could also lead to practical consequences that could hamper foreign investments in the Union.

[66] Ibid.

[67] Ibid.

[68] Gas Directive, art 9(8).

The unbundling requirements and the additional burdens put on third countries' entities seen above could discourage investments from companies specialised in the international gas supply. These are entities with extensive experience and know-how in the sector. The progressive disinvestment of these companies could cause problems to the management of the infrastructure and worsen the coordination between the transmission manager and the market operators. In the end, this would increase the transaction costs for the supply of the good to the final consumers. Transactions costs are, in economic terms, the costs which have to be borne for capturing the gains from specialisation and the division of labour.[69] Integrated companies (or companies part of the same group) which share the same management and pursue the same goals bear minor transaction costs and therefore operate more efficiently in the market.

Besides, the unbundling weakens natural gas companies in relation to third country producers. This is because the independent management over the network, coupled with the presence of several competitors as a result of the liberalisation of the sector, lowers the quantities of natural gas transported by each unbundled undertaking.[70] In addition, third countries' producers are often vertically integrated state-controlled entities (this is the case for Russia, Norway, Libya, Algeria and Qatar, the main EU gas suppliers) with the complete control over the natural resources of their territory. In principle, this disparity impairs the bargaining power of European companies and is likely to increase the price negotiated with the producers. However, this gap is not fully reflected on natural gas prices because technical innovations (LNG, fracking), coupled with a smaller-than-

[69] Maria Altmann, *Contextual Development Economics: A Holistic Approach to the Understanding Economic Activity in Low Income Countries* (Springer 2010) 34.

[70] Justus Haucap, 'The Costs and Benefits of Ownership Unbundling' (2007) 42(6) Intereconomics 301–306; Michael Pollitt, 'The Arguments for and against Ownership Unbundling of Energy Transmission Networks' (2007) 36(2) Energy Policy 704-713.

expected EU consumption due to the economic crisis and the booming of US internal gas production,[71] led to a global oversupply which impacted on the gas prices, dramatically increasing the gap between the price set in long-term agreements and the price set in the spot markets.[72] Since 2008, gas prices plummeted in the spot markets (where gas is traded on a daily basis) and many long-term contracts tying buyers to suppliers were renegotiated or subjected to arbitration. In 2015, European hub prices fell to their lowest level since 2009, as a combination of low oil prices, steady LNG supply, mild winter temperatures and robust pipeline imports put downward pressure on prices.[73]

Big suppliers benefit from more cash resources and banks' credit standing because of their bigger assets, know-how and revenues.[74] For these reasons, a situation where

[71] See US Energy Information Administration, 'Shale Gas Production' (2017) <https://www.eia.gov/dnav/ng/n g_prod_shalegas_s1_a.htm> accessed 23 April 2018.

[72] Long-term agreements are the typical contractual instrument tying natural gas final suppliers to the producers, who use them to secure a minimum amount of gas sold for a consideration indexed to international oil prices. This guarantees the utilisation of the network, the pay-back of the investments made for the construction and the operation of the pipelines, and an extra profit. National suppliers sign these contracts to benefit from stable prices and secured amounts of gas over a long period of time. Long-term gas contracts usually include take-or-pay clauses. These ensure that the seller will have a guaranteed income for the whole duration of the contract, while the buyer commits himself to a minimum amount of gas. See Luca Franza, 'Long-Term Gas Import Contracts in Europe: The Evolution in Pricing Mechanisms' (2014) Clingendael International Energy Programme <http://www.clingendaelenergy.com/inc/upload/files/ Ciep_paper_2014-08_web_1.pdf> accessed 24 July 2017; David Buchan, 'Europe's Energy Security-Caught between Short-Term Needs and Long-Term Goals' (2014) The Oxford Institute for Energy Studies, 3 <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/07/Europes-energy-security-caught-between-short-term-needs-and-long-term-goals .pdf> last access 24 July 2017. See also Alexander Boudiaf and Yuri Yegorov, 'US Shale Gas Revolution and World Gas Supply Shock' (2012) USAEE Working Paper 2142180/2012, <http://ssrn.com /abstract=2142180 or <http://dx.doi.org/10.2139/ssrn.2142180> last accessed 22 August 2014.

[73] European Commission, 'Quarterly Report on European Gas Markets' (2016) 4 <https://ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q4_2015-q1_2016.pdf> accessed 24 July 2017. Because of falling gas prices, the EU's gas import bill decreased of one billion Euros in 2015 (ibid).

[74] To date, the strongest undertakings in the European energy market are still those which were vertically integrated and benefited from a legal or *de facto* monopoly. The number of the so-called 'IMPRO' companies (*i.e.* the companies which either produce natural gas by indigenous production or bring natural gas into the country by import) that have a market share above 5% is important to understand the pro-competitive impacts of the European interventions in the energy market. Statistics on IMPRO companies can be found on Eurostat website (http://ec.europa.eu/eurostat/statistics-explained/index.php/ Natural_gas_market_indicators, last accessed 9 April 2018).

investment incentives are scarce could endanger the realisation of the interconnection projects which are essential for the development of the European pipelines network. The need for these infrastructures was already underlined in the 2007 Inquiry carried out by the European Commission,[75] and was one of the main drivers for the adoption of the Gas Directive.[76] The construction of interconnection projects can cost up to several billion Euros. To give one example, the total expenses for the construction of the Lithuanian-Polish interconnectors amount to 558 Million Euros,[77] and even smaller projects (e.g. the interconnector linking Greece to Bulgaria) require a significant funding.[78] Even if these are projects of relevant public interest, because of the rigid rules on deficit spending put on EU countries (e.g. Maastricht parameters and Fiscal Compact) they are mainly funded by the private sector. However, private entities act in the economy following a mere profit-driven logic which significantly differs from the reasons underlying State interventions.

When private entities decide to invest in infrastructure, they act on the basis of specific revenue models which allow them to amortise the cost of the projects over a certain period of time and guarantee a well-determined premium for their business initiative. Nowadays, the realisation of energy and infrastructure projects is often based on debt financing and project financing.[79] In particular, from an investor perspective project financing

[75] European Commission, 'DG Competition Report on Energy Sector Inquiry' SEC (2006) 1724, 16.

[76] Gas Directive, recital 57.

[77] European Commission, 'First Gas Interconnector Between Poland and Lithuania Ends Energy Isolation of the Baltic States' (2015) <https://ec.europa.eu/energy/en/news/first-gas-interconnector-poland-%E2%80%93-lithuania-ends-energy-isolation-baltic-states> last accessed 9 April 2018.

[78] Specifically, 220 Million Euros. Source: Euractive, 'Five Offers Made for Use of Greece-Bulgaria Gas Interconnector' (2016) <https://www.euractiv.com/section/energy/news/five-offers-made-for-use-of-greece-bulgaria-gas-interconnector/> last accessed 9 April 2018.

[79] Andrey Konoplyanik, 'Financing the Russian Oil and Gas Sector: The Effects of International Law Instruments' (2003) Journal of World Investment&Trade 946; Ernst&Young, 'Funding Challenges in the Oil and Gas Sector' (2014) 2 <http://www.ey.com/Publication/vwLUAssets/EY-Funding-challenges-in-

significantly lowers investment risks because it separates the single projects to be made from the overall activities and assets of the investing entity. Project financing requires the constitution of small capital companies (so-called 'project companies'), aimed at the realisation of a single project at a time. These companies are financed by the lending banks on the basis of their projected revenues and in exchange of a whole bunch of securities.[80] The stability and the predictability of future revenues are essential for a project to be financed.[81] In the case of natural gas infrastructures, these requirements are satisfied by the projected revenues deriving from the application of the transportation prices set out by NRAs for each 'regulatory period'.[82]

As mentioned in section 2.1.4, the infrastructure projects built after 3 September 2009 have to satisfy the ownership unbundling regime.[83] This means that the project companies used to realise new infrastructure projects cannot be controlled by natural gas or electricity producers or sellers. In order to comply with the ownership unbundling regime, these latter entities must take part to project companies together with other subjects which, in turn, shall respect the ownership unbundling provisions.[84] As a consequence, two non-EU companies which produce or supply natural gas in Europe cannot jointly participate to a project company, as one of them will always be in a position of control over the project company.

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the-oil-and-gas-sector/$FILE/EY-Funding-challenges-in-the-oil-and-gas-sector.pdf> accessed 18 August 2017.

[80] For an overview of project financing, see Graham Vinter, *Project Finance* (3rd edn, Thomson 2006).

[81] Scott Hoffman, *The Law and Business of International Project Finance* (CUP 2007) 99.

[82] In any event, tariffs are subject to changes from one regulatory period to another. A regulatory period normally lasts 5 years, however, the single regulatory authorities determine its duration.

[83] Gas Directive, art 9(1).

[84] An example can be found in OFGEM, 'Certification of Transmission System Operators under the Third Package – Consultation' (2010) 17 <https://www.ofgem.gov.uk/ofgem-publications/59366/3rd-pk-unbundling-con-docfinal.pdf> accessed 8 September 2014.

The unbundling also applies when the investing companies are more than two, as long as one supplier and/or seller controls the TSO. As noted in section 2.1.1, 'control' is defined very broadly under the Gas Directive,[85] and includes indirect control – i.e. through subsidiaries – and the so-called 'negative control', whereby minority shareholders enjoy veto rights on strategic decisions of the company concerning budget, appointment of management, investments and business planning.[86] Therefore, the possibility for a producer and/or supplier to participate to project companies shall be verified on a case-by-case basis by the regulatory authority.[87] The evaluation to be made shall consider the articles of incorporation and the statute of each project company to verify the powers granted to the relevant shareholders. Clearly, the more subjects participate to a project company's incorporation, the more difficult is the coordination between them. Hence, gas producers and suppliers face a trade-off: invest in infrastructure development with third subjects without the possibility to control the relevant TSO and with a significant transaction costs increase or not participate at all. Evidently, these two solutions do not encourage foreign companies' investments in the Union.

Another issue for potential investors derives from the TPA obligations put on the infrastructure manager by Article 32 of the Gas Directive. As mentioned in section 2.2 of this chapter, TSOs are subject to strict requirements which are designed to guarantee the

[85] Linklaters LLP (n 15).

[86] European Commission, 'Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas: The Unbundling Regime' (2009) 8 <http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/implementation_notes/2010_01_21_the_unbundling_regime.pdf> accessed 6 January 2014.

[87] This is evident in the practice. According to Filip Moerman, Francesco Maria Salerno and Fabio Chiovini, energy lawyers at Cleary Gottlieb LLP, 'investors will need to make a convincing case, through detailed and effective mechanics, that the risk for conflict of interest and undue influence is properly contained'. See Cleary Gottlieb LLP, 'Investing in Energy in The EU – Navigating the Ownership Unbundling Rules' (2016) <https://www.clearymawatch.com/2016/02/investing-in-energy-in-the-eu-navigating-the-ownership-unbundling-rules/> accessed 6 January 2017.

impartial access to the natural monopoly. The reason behind that is evident. Without this obligation, TSOs could undertake actions aimed at discriminating between one or more users. The beneficiary of these actions could directly or indirectly be part of the same group of companies (in view of the group interest), or it could be a third company unrelated to the TSO (private interest reason).

Access to the infrastructure is important to enable natural gas suppliers to compete in the downstream sector. There is a close relationship between the degree of access to the natural monopoly, the quantity of natural gas bought by domestic suppliers, the price paid to the producers, the price charged to final customers by domestic suppliers and the competitiveness of a company in the market. In principle, competitors damaged by unequal terms of access to the pipelines could suffer by paying higher prices to producers due to their relatively weak bargaining power. This could be the result of the limited amount of gas transported because of discriminatory capacity allocation mechanisms. The weaker companies might charge higher prices to their final customers to obtain the same profit per unit of the good transported. In a competitive context, this reduces the quantity of natural gas sold to final customers. The damaged suppliers would be compelled to reduce their profits per unit to lower the prices to final customers and compete in the retail market with the advantaged companies. However, this would still be an issue for the recovery of the investments done and the financial statements of the damaged companies. By definition, the sale of natural gas is the main source of revenues for a natural gas company. If revenues are too low, it is unlikely that a company could cover its liabilities, including the amortisation costs of the infrastructure built.

As seen, to prevent the drawbacks linked to the unfair management of the natural monopoly, the EU introduced TPA rules.[88] However, it is exactly because of the TPA that the incentives for private parties to invest in European infrastructure projects have decreased. This is because TPA lowers the projected revenues of the investments in the infrastructure by imposing pro-competitive obligations on the market operators.[89]

To prevent the underinvestment in 'major and new' natural gas pipelines, Article 36 of the Gas Directive provides for exemptions applying to unbundling and TPA rules. The requesting entity must meet five conditions to derogate from Articles 9 and 32 of the Gas Directive: (i) the new infrastructure has to enhance competition in the natural gas supply and secure the gas supply; (ii) the investment would not be made without the concession of a derogation to unbundling and third party access; (iii) the infrastructure must be owned by a natural or legal person which is separate, at least in terms of its legal form, from the system operators in whose systems that infrastructure will be built; (iv) charges must be levied on users of that infrastructure; and (v) the exemption must not be detrimental to competition or the effective functioning of the internal market in natural gas.[90]

These are the only criteria which can be used by NRAs to evaluate an unbundling and/or a TPA exemption request. The general nature of the clauses above could open the door to a possible discretionary application of the exemptions. Article 36 does not refer to objective criteria such as measurement systems or quantitative parameters. Discretion could be used not only when deciding whether to grant an exemption, but also when

[88] See section 2.2.

[89] According to Konoplyanik 'mandatory third party access prohibits project financing'. See Andrey Konoplyanik, 'Russia and the Third Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Including Non-EU Suppliers) and Consumers' (2011) 8 International Energy Law Review 36.

[90] Gas Directive, Art 36(1).

determining the duration of the derogation. In fact, pursuant to Article 36, exemptions can be also partial or temporary.[91]

To summarise, the Gas Directive does not seem to give the right investment incentives to private energy companies for several reasons. The first one is the loss of domestic suppliers' bargaining power due to the break-up of national markets and the introduction of the unbundling, which lowers the amounts of gas traded.[92] The fact that to date the gas price on the spot market is unexpectedly low is not relevant, albeit in practice this counter-balances the bargaining power loss. Secondly, companies operating in the production and/or supply of gas cannot exercise a decisive influence on European TSOs. Why do you have to invest in a sector if you know you will face strong limitations to your operation? Remarkably, these restrictions extend to the electricity market and to projects already in operation.[93] Lastly, the uncertainty of getting an exemption under Article 36 exponentially increases the risk assumption of the investing companies, which may not get their investments repaid. In the end, all of this could endanger the security of supply of the EU and its Member States.

The possibility of benefitting from exemptions is key for new projects that want to be financed, since private investors need to evaluate in advance the likelihood of profitability of the investments to be made. One of the current priorities for EU policymakers is to accelerate final investment decisions on key gas infrastructure projects, so-called Projects of Common Interest ('PCIs'), the majority of which relate to natural gas transportation.[94]

[91] Gas Directive, art 36(1). See also footnote 42.

[92] Haucap and Pollitt (n 70).

[93] As seen in section 2.1, the unbundling provisions of the Gas Directive and of Directive 2009/72/EC reciprocally apply in their respective markets.

[94] European Commission, 'Questions and Answers: Projects of Common Interest in Energy' (2015) <https://ec.europa.eu/energy/sites/ener/files/documents/PCI_MEMO_PresCab.pdf> accessed 29 February 2016. See: European Commission, 'Communication from the Commission to the European Parliament, the

These are projects fulfilling the following characteristics: (i) impact significantly on at least two EU countries; (ii) enhance market integration and contribute to the integration of EU countries' networks; (iii) increase competition on energy markets by offering alternatives to consumers; (iv) enhance security of supply; and (v) contribute to the EU's energy and climate goals.[95] Candidate projects are proposed by their promoters and are evaluated by Regional Groups that include representatives from EU countries, the Commission, TSOs, project promoters, regulatory authorities and the Agency for the Cooperation of the Energy Regulators ('ACER'). After this assessment, the Commission adopts the list of approved PCIs via a delegated act procedure and then submits the list of projects to the Parliament and the Council.[96] These institutions have two months to reject the list, or they may ask for an extension of two months to finalise their position. If neither the Parliament nor the Council rejects the list, it enters into force.[97] The list of PCIs is updated every two years to integrate newly needed projects and remove obsolete ones. PCIs are provided with accelerated permit granting procedures and a faster environmental assessment process.[98]

The transition towards a more secure and sustainable energy system will require major investments in energy generation, networks and energy efficiency, estimated at some 200

Council, the European Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: On an EU Strategy for Liquefied Natural Gas and Gas Storage' COM (2016) 49 final, 12.

[95] European Commission, 'Energy Strategy' (2017) <https://ec.europa.eu/energy/en/topics/energy-strategy-and-energy-union/2030-energy-strategy> accessed 29 April 2017.

[96] European Commission, 'Questions and Answers: Projects of Common Interest in Energy' (2015) <https://ec.europa.eu/energy/sites/ener/files/documents/PCI_MEMO_PresCab.pdf> accessed 29 February 2016.

[97] European Parliament and European Council Regulation 347/2013 of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations 713/2009, 714/2009 and 715/2009 [2013] OJ L115/39.

[98] Ibid.

billion Euros annually in the next decade.[99] For this reason, while the private sector will bear the costs of most of these investments, right investment incentives and access to financial support will be key factors to support the expected growth.

## 5. The Impact of the Gas Directive at the International Level

As mentioned in the introduction of this work, the analysis of the economic dependency relations is key to evaluate the position of a country towards all the others in a well-determined sector. Dependency relations ultimately depend on the amount of goods and services traded from one country to another. For this reason, trade relationships between market operators, especially when monopolists, shape the geopolitical relations of their countries of origin. This is all the more true when dealing with the energy sector, due to its strategic importance and the pervasive role of the State in the field.

Hence, the impact of the Gas Directive on international trade, especially with regard to the 'third country clause', is relevant to understand the position of the EU in the energy relationship with Russia. International trade is ruled by WTO agreements, which, as seen in chapter I, have been ratified by both the EU and Russia and are the only effective means of redress which currently bind both countries at the international level. Therefore, the analysis of the Gas Directive impact on the EU-Russia energy relationship cannot do without an assessment of compliance of the Gas Directive with the WTO rules. This enquiry is particularly significant also in light of the request for consultation before the WTO Dispute Settlement Body which has been filed by Russia against the EU on the

[99] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of Regions, and the European Investment Bank: A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy' COM (2015) 080 final, 8.

same topic, and considering the impact of the Gas Directive on the investment incentives of private entities analysed in the previous sections of this chapter.[100]

The outcome of this investigation could be key to determining the possible resolution of the tensions which currently permeate the EU-Russia energy relationship. Indeed, in principle, it could trigger major changes in the European gas supply, either leading towards a more pro-EU (e.g. a progressive diversification both of the suppliers and of the energy sources) or pro-Russia (e.g. strengthening the position of Gazprom in the EU midstream and downstream markets) energy future. Moreover, a manifest illegality of the Gas Directive would considerably influence the investment incentives put on the undertakings concerned by the Third Energy Package.

## 6. Interim Conclusion

This chapter outlined the main features of the Gas Directive (unbundling, third party access, third country clause) which could impact on the EU-Russia balance of power.

In particular, we have seen that Article 11 of the Gas Directive imposes burdensome requirements on foreign undertakings willing to operate as TSOs in the EU. The criteria set out under Article 11 hide a potential discrimination between undertakings of different countries of origin which could affect the operation and the investment opportunities of non-EU countries' entities in the EU energy market. Notably, this could negatively impact on the amount of goods and services traded and, in the end, even go against EU security interests.

[100] The request for consultation of Russia can be found at the following link: <https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%20@Symbol=%20(wt/ds476/1%20))&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#>, accessed 24 August 2014.

The third country clause has been at the centre of the public debate since the preparatory works of the Gas Directive and still it is a hot topic of discussion. The negative impact of Article 11 on Russia's interests in Europe cannot be summarised better than in the words of President Putin, who defined it as a 'robbery'.[101]

EU pieces of energy legislation, such as the Gas Directive, must comply with international law rules binding the EU in the energy field. For this reason, in the next chapter we will analyse the Gas Directive *vis-à-vis* WTO rules which, as seen in chapter I, are the most suitable international legal tool that can be used to assess an internal measure which impacts on the EU-Russia energy relations.

Our research will focus on the non-discrimination and the market access provisions of the General Agreement on Tariffs and Trade and of the General Agreement on Trade in Services since those are the main rules invoked by Russia in the request for consultation filed to the WTO DSB.

[101] Gleb Bryanski, 'Putin Says EU Energy Laws Are Uncivilised 'Robbery'' (2010) <http://in.reuters.com/article/2010/11/26/idINIndia-53174220101126> accessed 1 December 2017.

# III

## THE ASSESSMENT OF THE GAS DIRECTIVE AGAINST WTO RULES

**Summary**: 1. Introduction – 2. Most Favoured Nation – 3. National Treatment – 4. Quantitative Restrictions – 5. Market Access Barriers to Services – 6. General Exceptions – 7. Security Exceptions – 8. Interim Conclusion.

### 1. Introduction

In the previous chapters, we have outlined the basic economic, geopolitical and regulatory features characterising the EU natural gas market. This gave us the necessary background knowledge to begin the legal investigation aimed at assessing the compliance of Directive 2009/73/EC ('the Gas Directive') with international trade rules.

This chapter will assess the Gas Directive *vis-à-vis* the rules of the World Trade Organization ('WTO'). The prohibition for natural gas producers and retailers to hold a quota amounting to the control of European gas transportation companies ('TSOs'), seen in the previous chapter, could bear consequences on the production and sale of natural gas in the European market. By the same token, third party access to pipelines and energy network management rules could affect third country gas companies. Therefore, the analysis of the compliance of the Gas Directive with the provisions included under the General Agreement on Tariffs and Trade ('GATT') and the General Agreement on Trade in Services ('GATS') is highly relevant.

Even though the two agreements regulate different matters – the GATT deals with the regulation of international trade of goods, whereas the GATS protects trade in services –

they are not mutually exclusive and, therefore, they can be applied to assess the same regulation.[1]

The legal analysis will be made by testing the relevant provisions of the Gas Directive against the antidiscrimination and market access rules of the GATT and the GATS, in light of the applicable case law. We will conclude that the Gas Directive does not seem to comply with some of the rules analysed and that the EU could not rely on the application of the general and security exceptions laid down under the GATT and the GATS to justify the breach of WTO rules. This answers to the second question set out in the introduction of this work.[2]

The scenario depicted will empower Russia with a remedy, the enforcement of which could impact on its energy relationship with the EU, mandating a change of EU legislation to the advantage of Gazprom's operations in the EU internal market.

## 2. Most Favoured Nation

One of the backbones of international trade is known as 'most favoured nation' (hereafter, 'MFN'). This principle, whose origin dates back at the early stages of multilateral trade negotiations,[3] is present both under the GATT (Article I) and under the GATS (Article II).

[1] Appellate Body Secretariat, *WTO Appellate Body Repertory of Reports and Awards 1995-2010* (CUP 2011) 381. See also Simon Lester and Bryan Mercurio, *World Trade Law: Text, Materials and Commentary* (Hart Publishing 2008) 603.

[2] In the introduction we posed the following question: 'Is the EU intervention in the natural gas field compliant with the international law rules binding the Union in the field?'. See page 11.

[3] The origin of the MFN clause dates back to the Holy Roman Empire. The drafters of the WTO agreements took inspiration from the formulation of the MFN clause as developed by the League of Nations.

The main obligation imposed by MFN is that any advantage granted from one WTO member to a State, irrespective of whether this latter is a WTO member or not,[4] must be granted 'immediately and unconditionally' to all the other WTO members.

MFN covers not only *de jure* discriminatory behaviours but also *de facto* discrimination.[5] Hence, measures that appear to be origin-neutral could fall within the scope of application of the MFN principle.

Object of this section is the assessment of the Gas Directive as regards its compatibility with the MFN clauses of the GATT and the GATS.

### 2.1 Most Favoured Nation under the GATT

Pursuant to Article I(1) of the GATT:

> any advantage, favour, privilege or immunity granted by any Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Members.

WTO case-law developed a three-fold assessment to verify the consistency of a measure with the MFN clause of the GATT.[6] In particular, we shall assess: 1) whether the measure adopted by a WTO Member confers a 'trade advantage' in the meaning of Article I; 2)

[4] Petros Mavroidis, *Trade in Goods* (OUP 2012) 129.

[5] *Canada – Certain Measures Affecting the Automotive Industry – Report of the Appellate Body* (31 May 2000) WT/DS139/AB/R [78] with reference to the GATT and *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Report of the Appellate Body* (9 September 1997) WT/DS27/AB/R [233] with reference to the GATS.

[6] UNCTAD, 'Dispute Settlement: World Trade Organization 3.5 GATT 1994' (2003) 14 <http://unctad.org/en/docs/edmmisc232add33_en.pdf> accessed 3 March 2015; Peter Van Den Bossche, *The Law and the Policy of the World Trade Organization* (2nd edn, CUP 2009) 325.

whether the products concerned can be considered as 'like products'; and 3) whether the advantage is granted 'immediately and unconditionally' to all like products of the other WTO Member States ('MSs'). An affirmative answer to the first two questions and a negative answer to the third one entail a breach of the MFN obligation by the WTO Member which adopted the measure under investigation.

### *2.1.1 The Definition of 'Trade Advantage'*

The first element of the test demands that the trade advantage granted by the contested measure to one or more Countries can be included under the ones covered by Article I GATT. Accordingly, the relevant advantage shall relate, *inter alia*, to 'all rules and formalities in connection with importation and exportation [of a product] and with respect to all matters referred to in paragraphs 2 and 4 of Article III'.[7] Article III GATT will be analysed in depth below, in section 3 of this chapter. For the time being, it is sufficient to note that its fourth paragraph focuses on the regulatory measures adopted by WTO Members which could impact, *inter alia*, on the transportation of a product.

The Gas Directive could fall both under Article III(4) and among the 'all rules and formalities connected with importation' of Article I. In the absence of any definition of the expression in the GATT, we shall refer to the rules of customary international law for the interpretation of the treaties set out in the Vienna Convention on the Law of the Treaties.[8] Accordingly, the interpretation of an international treaty shall be made having

[7] Article I(1) GATT.

[8] As regards the interpretation of WTO covered agreements, Article 3(2) of the WTO Dispute Settlement Understanding explicitly refers to 'customary rules of interpretation of public international law', which has been consistently interpreted by the Panels and the Appellate Body to refer to the Vienna Convention on the Law of the Treaties. In particular, the Appellate Body acknowledged the importance of the Vienna Convention on the Law of the Treaties for the interpretation of WTO rules in *US-Gasoline* and interprets WTO law with reference to it ever since. See: Danae Azaria, *Treaties on Transit of Energy Via Pipelines and Countermeasures* (OUP 2015) 14; Lars Albath, *Trade and Energy: Investment in the Gas and Electricity Sectors* (Cameron May 2004) 67.

regard to the ordinary meaning of the wording used, in accordance with the object and purpose of the treaty.[9] In this respect, the Gas Directive could fall within the ordinary meaning of the expression 'rules and formalities connected to importation'.[10]

Remarkably, the scope of application of the MFN clause is very broad, as it covers both actual and potential discrimination.[11] This means that MFN does not require that an 'advantage' is actually granted by the Gas Directive to a third country, it being enough that the regulation could potentially discriminate between entities.

As seen in the previous chapter,[12] the certification procedure laid down under Article 11 of the Gas Directive could be discretionary, being based on the circumstances of the case and on the international agreements in place between the EU and the motherland of the undertakings concerned. In this respect, the fact that there are different (or indeed no)

[9] Article 31 of the Vienna Convention on the Law of the Treaties states that 'A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. We may have recourse to supplementary means of interpretation in accordance with Article 32 of the Vienna Convention to confirm the meaning resulting from the application of Article 31, or to determine the meaning of the terms if we conclude that the interpretation according to Article 31 leaves the meaning ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable. See Martin Dixon, *International Law* (6th edn, OUP 2007) 59; Malgosia Fitzmaurice, Olufemi A Elias, Panos Merkouris, *Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years On* (2010 Martinus Nijhoff Publishers).

[10] Pursuant to the Oxford Dictionary, 'rule' is defined as: 'one of a set of explicit or understood regulations or principles governing conduct or procedure within a particular area of activity'. The same dictionary defines 'formality' as 'the rigid observance of convention or etiquette'. 'Connected' is defined as 'associated or related in some respect'. 'Importation' means 'the bringing of goods or services into a country from abroad for sale'. Therefore, to be covered by Article I, the Gas Directive should set out explicit regulations or principles related to the bringing of gas in the EU from abroad. Notwithstanding the fact the Vienna Convention on the Law of the Treaties uses the expression 'object and purpose' eight times, it does not define it. However, the International Court of Justice has consistently interpreted that expression as referred to the title of the treaties, their preamble, the preparatory works, a programmatic provision, and an article showing the major concerns of the parties. See Danae Azaria, *Treaties on Transit of Energy Via Pipelines and Countermeasures* (OUP 2015) 112.

[11] Peter Van den Bossche and Werner Zdouk, *The Law and Policy of the World Trade Organization* (3rd edn, CUP 2013) 378.

[12] See Chapter II, section 2.3.

international treaties between the EU and non-EU Members may mean that there are different 'treatments' in the meaning of Article I GATT.

### *2.1.2 The Likeness Test*

The second element required by the MFN test under Article I(1) GATT is the assessment over the 'likeness' of the products concerned. There is no reference to the definition of 'likeness' in the WTO agreements.[13] That is why it is accepted that the concept of 'like product' has a different meaning in the different contexts in which it is used.[14] In the absence of a clear definition, we could apply to Article I the jurisprudence on 'likeness' of Article III GATT.[15]

Accordingly, two products are 'like' when they share the same physical properties, end-uses, consumer tastes and habits, and tariff classification.[16] These criteria are neither exclusive nor cumulative. Nothing shall prevent the adjudicative body from considering only some of the criteria listed or from referring to other indicators, provided that they

[13] Peter Van Den Bossche, *The Law and the Policy of the World Trade Organization* (2nd edn, CUP 2009) 329.

[14] Ibid.

[15] For Van den Bossche 'it is reasonable to expect that this case law regarding Article III will inform the concept of 'like products' under Article I'. On this line, the Panel in *Indonesia-Autos* stated that 'we have found in our discussion of like products under Article III:2 that certain imported motor vehicles are like the national cars. The same considerations justify a finding that such imported vehicles can be considered like national cars imported from Korea for the purpose of Article I'. Despite this apparent connection, Trebilcock and Howse underline that it is still unclear whether the same principles underlying 'likeness' under Art III are applicable also in case of Art I. See Michael Trebilcock, Robert Howse and Antonia Eliason, *The Regulation of International Trade* (6th edn, Routledge 2013) 75.

[16] The four-digit test has been adopted in several WTO cases and it is now accepted as the most relevant method to determine the likeness of the products concerned. See *Spain – Tariff Treatment on Unroasted Coffee – Report of the Panel* (11 June 1981) BISD 28S/102; *Canada I Japan – Tariff on Imports of Spruce, Pine. Fir (SPF) Dimension Lumber – Report of the Panel* (19 July 1989) BISD 36S/167; *United States – Certain Measures Affecting Imports of Poultry from China – Report of the Panel* (29 September 2010) WT/DS392/R.

reveal the competitive relationship between different products.[17] If two products are not considered as like, they can be subjected to disparate treatment.

In case of natural gas, the likeness test seems to be satisfied.[18] Natural gas is a substance with neither colour nor smell, and its gaseous form prevents the user from distinguishing between the countries of origin. Despite this, it is true that gases coming from different basins can have different caloric power and therefore be more appealing for certain end-uses rather than others. In addition, it is also true that natural gas can have different origins – apart from the subsoil extraction, it is produced from renewable sources (so-called 'biogas') – or it can be subject to transformational processes which impact on its natural state before its supply to the final customer (e.g. liquefied natural gas).

The jurisprudence of the WTO does not clearly state whether the processes and production methods may have an impact on the assessment on the 'likeness' of two products.[19] Arguably, if this is the case, one could say that 'grey' natural gas, products such as biogas and liquefied natural gas ('LNG') are not like products and therefore a different treatment of them could be justified.

However, whether LNG and biogas can be considered as different products from 'grey' natural gas or whether a difference should be made between gases with different caloric

[17] In this sense go the following cases: *European Communities – Measures Affecting Asbestos and Products Containing Asbestos – Report of the Appellate Body* (12 March 2001) WT/DS135/AB/R [109]; *United States – Measures Affecting the Production and Sale of Clove Cigarettes – Report of the Appellate Body* (4 April 2012) WT/DS406/AB/R [119 – 121] and *Philippines – Taxes on Distilled Spirits – Report of the Appellate Body* (21 December 2011) WT/DS396/AB/R [122; 170-183].

[18] Lars Albath *Trade and Energy: Investment in the Gas and Electricity Sectors* (Cameron May 2004) 100.

[19] Thomas Cottier, 'Renewable Energy and Process and Production Methods' (2015) E15 Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum 7 <http://e15initiative.org/wp-content/uploads/2015/09/E15-Climate-Change-Cottier-Final.pdf> accessed 28 April 2018.

powers does not seem to have any direct consequence on the evaluation of the likeness in relation to the MFN clause. This is because the Gas Directive does not set out any distinction between the different types of gas. Instead, it generally applies to 'natural gas', irrespective of its origin or natural state.[20] This leads us to consider that all third countries' gas and all European-produced gas are 'like products' for the purposes of our research.

*2.1.3 The Non-Discrimination Test*

The third element of the three-tier assessment under Article I(1) GATT is the so-called 'non-discrimination test', pursuant to which any advantage granted to the products of one State shall be given 'immediately and unconditionally' to the like products of all the other WTO Members.

According to the Panel in *Canada-Autos* 'whether conditions attached to an advantage granted in connection with importation of a product offend Article I(1) depends upon whether or not such conditions discriminate with respect to the origin of products'.[21] For that Panel, 'unconditionally' entails that the extension of an advantage to third countries may not be made subject to conditions in relation to the situation or conduct of those countries.[22] As a consequence, the imposition of conditions would breach the WTO rules only if it became a way to discriminate between countries.

Notwithstanding the above, the Panel in *EC – Tariff Preferences* adopted a stricter interpretation and saw 'no reason not to give that term its ordinary meaning under Article

[20] Gas Directive, art 1(1). Accordingly, 'this Directive establishes common rules for the transmission, distribution, supply and storage of natural gas. It lays down the rules relating to the organisation and functioning of the natural gas sector, access to the market, the criteria and procedures applicable to the granting of authorisations for transmission, distribution, supply and storage of natural gas and the operation of systems'.

[21] *Canada – Certain Measures Affecting the Automotive Industry* (n 5) [10.29].

[22] Ibid.

I(1) that is, 'not limited by or subject to any conditions''.[23] Clearly, the adoption of this interpretation would preclude the introduction of any condition in the measures adopted by WTO Members.

The Appellate Body newly intervened on the matter in the 2014 *EC-Seal* case, giving a broader interpretation of the matter, underlining that 'the non-discrimination test prohibits only those conditions that have a detrimental impact on the competitive opportunities for like imported products from any member'. [24]

However, even leaving aside the 'conditionality test', in our case it seems indisputable that Article 11 does not satisfy the 'immediateness' required by Article I GATT. In fact, even though the terms 'immediately' and 'unconditionally' are usually assessed simultaneously,[25] this does not mean that they cannot be analysed separately. This is justified by the fact that Article I uses the conjunction 'and', meaning that both requirements have to be cumulatively satisfied. According to Mavroidis, 'the term 'automatically' suggests the absence of time lapse between granting an advantage to one country and extending it to all WTO Members'.[26] In the Gas Directive, the certification process under Articles 10 and 11 takes several months and, even when a certification is

[23] *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries – Report of the Panel* (1 December 2003) WT/DS246/R [7.59].

[24] *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products – Report of the Appellate Body* (22 May 2014) WT/DS400/AB/R [5.88]. See Andrea K Bjorklund, *Yearbook on International Investment Law & Policy 2014-2015* (OUP 2016) 136. Mavroidis casts a shadow on the reasoning made by the Appellate Body in Petros Mavroidis, *The Regulation of International Trade* (MIT Press 2016) 214.

[25] Mavroidis (n 4) 145.

[26] Ibid.

granted to one undertaking of an advantaged third-country, it cannot be instantly extended to the companies of the other WTO Members.[27]

*2.1.4 Impact of the Gas Directive on Natural Gas Flows*

So far, we have concluded that the Gas Directive does not immediately extend to all third countries the advantages which it grants to some of them. This is at odds with the MFN principle. However, before upholding the existence of a breach, one aspect is still to be assessed.

We applied the MFN test of the GATT without questioning the effective impact of the Gas Directive on natural gas as a good. Indeed, the wording of the Gas Directive does not seem to affect gas as a product. Pursuant to its Article 1, the Gas Directive:

> establishes common rules for the transmission, distribution, supply and storage of natural gas. It lays down the rules relating to the organisation and functioning of the natural gas sector, access to the market, the criteria and procedures applicable to the granting of authorisations for transmission, distribution, supply and storage of natural gas and the operation of systems.

According to WTO case law, the impact on natural gas can derive not only from the 'face' of a regulation, but also from its application.[28] Nothing in the Gas Directive seems to

[27] In case of third countries' controlled companies, the timing for the authorisation can reach up to 10 months. After the notification of the controlled company, the NRA takes a draft decision within the following 4 months and notifies it to the European Commission. The European Commission gives an opinion on whether (i) the company at issue complies with the requirements of Art 9; and (b) the authorisation will not put at risk the security of energy supply to the Community. The European Commission will deliver its opinion to the relevant NRA within 2 months, extended by other 2 whether it requests the views of the Agency for the Cooperation of Energy Regulators, the Member State concerned, and the interested parties. Once received the opinion of the EC, the NRA takes a final decision within two months. In taking the final decision, the NRA shall take utmost account of the Commission's opinion. See Gas Directive, Arts 10 – 11.

[28] The possibility of including not only *de jure* but also *de facto* discriminatory actions under Article I GATT has been firstly outlined in *EC – Bananas III* where the Appellate Body, supporting the proposition

prevent or hamper companies operating in Europe from buying gas from third countries which are put at a disadvantage by Article 11 (e.g. Russia) and competitively supplying it to their final customers. In fact, the Gas Directive does not apply any charges or levies of any type and does not seem to impact on the conditions of supply of the imported good.

However, we have to bear in mind that Article I GATT has to be interpreted broadly and covers also potential discrimination,[29] so that there is no need to prove an actual discriminatory effect. Under this perspective, by preventing TSOs controlled by third country suppliers to operate, in theory Article 11 could block the gas flow in the importing country, in violation of Article I GATT. This situation finds a case in point when there is only one TSO operating in a EU Member. For instance, this happens in Latvia, Lithuania, Luxembourg, Belgium, Bulgaria, Finland and Denmark.[30]

### 2.2 Most Favoured Nation under the GATS

The MFN principle under the GATS is laid down under Article II(1). This provides that:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

While the MFN clause under the GATT lists several types of measures and incorporates regulations and internal taxes only by reference to the NT principle under Article III, the

that Article II GATS prohibits both types of discrimination, noted that Article I GATT applies also to *de facto* discriminatory measures. The same view was reiterated in *Canada-Autos.*

[29] Van Den Bossche and Zdouk (n 11).

[30] For the complete list of EU Members with one TSO only, see European Commission, 'Country Factsheet' (2013) <https://ec.europa.eu/energy/sites/ener/files/documents/201307-entry-exit-regimes-in-gas-parta-appendix. pdf> accessed 29 March 2015.

wording of Article II GATS seems to be broader, applying to 'any measure' adopted by a WTO MS. Focusing on the MFN discrimination aspect, the GATT obliges WTO MSs to extend any advantage, favour, privilege and immunity which is granted to one country to all the other WTO MSs. The GATS instead, prohibits the less favourite treatment of any WTO Member, an expression which echoes the broad formulation of the NT clause.[31] However, while the term 'treatment' seems to be wider than the words 'advantage', 'favour', 'privilege' and 'immunity', a broad interpretation of these latter expressions leads to the absence of a significant difference between them.[32]

As a preliminary consideration, the applicability of the exception laid down under Article I(3)(b) GATS cannot be supported in the case at issue. This clause prevents the application of the GATS in case of services supplied in the exercise of governmental authority.[33] This refers to services which are supplied neither on a commercial basis nor in competition with one or more other service suppliers. At first glance, gas transportation services which are provided at regulated prices by natural monopolists could fall within this category. However, Article VIII GATS derogates to Article I and sets out the obligation of the 'monopoly supplier of a service' – in our case, the TSO manager – to comply with the Member State's obligations under Article II and its specific commitments, including MFN.[34]

[31] Pursuant to Article XVII(1) GATS 'In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers'. See the analysis of the provision in sub-section 3.2.

[32] Nicholas Diebold, *Non-Discrimination in International Trade in Services: 'Likeness' in WTO/GATS* (CUP 2010) 136.

[33] Pursuant to Art I(3)(b) GATS: For the purposes of this agreement […] 'services' includes any service in any sector except services supplied in the exercise of governmental authority.

[34] This provision applies also 'where a Member's monopoly supplier competes, either directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights' (Article VIII(2) GATS).

The WTO Dispute Settlement Body ('DSB') formulated a three-fold assessment to detect a breach of the MFN under the GATS.[35] Accordingly, we shall evaluate 1) whether the measure adopted by a WTO Member is a measure within the scope of the GATS; 2) whether the services or the service suppliers concerned satisfy the 'likeness test'; and 3) whether there is a 'less favourable treatment' of the services or of the service suppliers of a WTO Member in relation to any other country - not only *de jure*, but also *de facto*.[36]

### *2.2.1 The Definition of 'Measure under the GATS'*

The assessment on whether the Gas Directive is a measure within the scope of the GATS is rather straightforward, considering the broad definition of 'measure' included under Article XXVIII GATS (Definitions),[37] and the fact that, as seen in Chapter I,[38] 'trade in service' related to natural gas falls within the categories of cross-border supply and commercial presence of Article I GATS.

### *2.2.2 The Likeness Test*

The second element of the MFN test is the 'likeness' of the services or of the service providers concerned. There is little case-law on the interpretation of those expressions under the GATS. As we have seen in chapter I, there is no definition of 'service' under the GATS.[39] However, the same agreement explains the meaning of 'service supplier' in

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[35] *Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines – Report of the Appellate Body* (17 June 2011) WT/DS371/AB/R [127].

[36] *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Report of the Appellate Body* (9 September 1997) WT/DS27/AB/R [234].

[37] Pursuant to Article XXVIII(a) GATS, a 'measure' in the meaning of the GATS is 'any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form'. See also section 2.1.2 above.

[38] Chapter I, section 5.2.2.

[39] Ibid.

Article XXVIII GATS (Definitions), according to which a 'service supplier' is 'any person that supplies a service'. This broad definition can certainly be applied to the undertakings operating in natural gas transportation.

The unbundling rules set out under Article 9 of the Gas Directive apply to companies working in the transportation sector – 'service providers' in the meaning of the GATS. This is a relatively small environment because of the small number and the similar characteristics of the operators working therein. These are natural monopolist companies that manage the high-pressure pipelines constituting the spine of the natural gas delivery to final customers. In principle, each country has one main company operating in the transportation sector.

Transportation companies share the same characteristics and satisfy the same basic need - the safe transportation of natural gas through the pipelines they manage. For these reasons, it is unlikely that a customer would perceive the difference of switching from one TSO to another governing the same pipelines. This is also because transportation tariffs in Europe are set at standard prices by the national regulatory authorities. For these reasons, the transportation companies targeted by the Gas Directive can be considered 'like service suppliers' under Article II GATS.

*2.2.3 The Non-Discrimination Test and the Exception under Article II(2) GATS*

The last element of the three-tier MFN test is the 'non-discrimination' assessment. Pursuant to Article II, WTO members shall accord 'immediately and unconditionally' to services and to service suppliers of other WTO members no less favoured treatment than the one granted to the like services and the like service suppliers of any other country. Article II case-law does not explain the meaning of the expression 'less favourable

treatment'. However, the same periphrasis is used also under Article XVII(3) GATS, pursuant to which:

> Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.[40]

Article XVII sets out the NT obligations under the GATS. The definition of less favourable treatment under Article XVII seems to be applicable to Article II since both MFN and NT underlie the same non-discrimination principle, which necessarily excludes any contradiction.

Hence, the non-discrimination test is the assessment upon the modification of the conditions of competition in favour of one or more countries due to the adoption of a certain measure. In principle, pursuant to the Gas Directive all third countries operators are banned from controlling European TSOs.[41] This seems to be coherent with the concept in which a member that bans trade with all foreign suppliers does not violate the MFN. However, even though no distinction is formally – *de jure* – made by the Gas Directive, its wording could hide a *de facto* discrimination.

Indeed, as soon as a third country enters into an agreement in the energy field with the EU, its undertakings are eligible to obtain a waiver amounting to a more favourable treatment. Pursuant to Article II GATS, the favourable treatment towards the companies of one or more countries must be granted 'unconditionally and immediately' to the

[40] Art XVII(3) GATS.

[41] Article 11 of the Gas Directive does not expressly make any distinction between the TSOs operating in the Union which are controlled by different non-EU entities.

undertakings of the other WTO Members. However, the Gas Directive dictates this could not be done because the steps to grant the certification to third countries' companies last up to 10 months – irrespective of the immediateness requirement – and the process to go through is in any event subject to the conditions set out under Article 11, which, as seen, depend on the international relations between the relevant third country and the EU.

A less favourite treatment could primarily arise in respect to the members of the European Energy Community, non-EU States which decided to liberalise their energy markets in accordance to the European unbundling rules. In case the certification required by the Gas Directive would be issued to any undertaking of these third States, Russia – which has no specific agreement in place with the EU on energy – or any other third country in the same position would be entitled to claim a breach of the MFN.

In addition to the international agreements in place, the evaluation to be made by the competent national regulatory authority considers also the 'circumstances of the case'. No rule has been set out to interpret this periphrasis, thus it is not guaranteed that the same balance will be used by the different national regulators throughout the Union. Hence, the two criteria laid down under Article 11 of the Gas Directive *de facto* result in a less favourable treatment of some WTO Member States.

Moreover, even if there are no DSB precedents, it is reasonable to assume that Article II GATS also covers potential discrimination. This hypothesis analogically applies the same considerations seen above in case of MFN under the GATT.[42] In this way, Russia and other 'potentially disadvantaged' countries could uphold the existence of a breach of the MFN by relying only on the wording of the Gas Directive.

[42] Section 2.1.1 *supra*.

In case of breach of Article II(1), the Member State concerned could rely on the provision of Article II(2) providing that 'A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions'.[43] This clause lays down an express derogation to MFN which applies also when the exceptions under Article XIV and XIV-bis are not applicable.[44] However, since the EU has not listed any exception with regard to transport services via pipeline of petroleum and natural gas and services incidental to energy distribution in its WTO access schedules, it cannot rely on the application of Article II(2).

### 3. National Treatment

National Treatment (hereafter, 'NT') is with MFN one of the most important anti-discrimination principles of WTO, present both under the GATT (Article III) and the GATS (Article XVII). What distinguishes NT from MFN is that while the latter focuses on the relationships between trading partners, the former prohibits discriminatory behaviours with domestic goods or services.[45] Not only to *de jure* and actual

[43] Article II(2) GATS.

[44] These are the general and security exceptions of the GATS, which we will analyse in sections 6 and 7 below. Pursuant to the Annex on Exemptions, 'The Council for Trade in Services shall review all exemptions granted for a period of more than 5 years. The first such review shall take place no more than 5 years after the entry into force of the WTO Agreement. The Council for Trade in Services in a review shall: (a) examine whether the conditions which created the need for the exemption still prevail; and (b) determine the date of any further review. The exemption of a Member from its obligations under paragraph 1 of Article II of the Agreement with respect to a particular measure terminates on the date provided for in the exemption. In principle, such exemptions should not exceed a period of 10 years. In any event, they shall be subject to negotiation in subsequent trade liberalizing rounds. A Member shall notify the Council for Trade in Services at the termination of the exemption period that the inconsistent measure has been brought into conformity with paragraph 1 of Article II of the Agreement'.

[45] *United States – Section 337 of the Tariff Act of 1930 and Amendments thereto – Report of the Panel* (unadopted) WT/DS186/R [5.10].

discriminatory conducts, but also *de facto* and potential discrimination is prohibited under the NT principle.[46]

Differently from the GATT, NT commitments under the GATS are applicable only insofar WTO members have positively accepted them for a well-determined sector or sub-sector of activity of their Schedules of Specific Commitments.[47]

Object of this section is the assessment of the Gas Directive *vis-à-vis* the NT clauses of the GATT and of the GATS.

### 3.1 National Treatment under the GATT

Pursuant to Article III(1) GATT:

> The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions should not be applied to

[46] *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes – Report of the Appellate Body* (25 April 2005) WT/DS302/AB/R [96]; *United States – Measures Affecting the Production and Sale of Clove Cigarettes – Report of the Panel* (2 September 2011) WT/DS406/R [7.261]. See Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis, *The World Trade Organization: Law, Practice and Policy* (OUP 2006) 157.

[47] The 'specific commitments' are included into tables published on the WTO website where MSs specify the limitations and the notes they have in relation to each sector and subsector of the W/120 classification. See Thomas Cottier, Sofya Matteotti-Berkutova and Olga Nartova, 'Third Country Relations in EU Unbundling of Natural Gas Markets: The 'Gazprom Clause' of Directive 2009/73/EC and WTO Law' (2010) NCCR Working Paper 6/2010, 10 <http://www.nccr-trade.org/publication/third-country-relations-in-eu-unbundling-of-natural-gas-markets-the-gazprom-clause-of-directi/> last accessed 26 August 2014. For an exhaustive explanation of the functioning of the Schedules of Specific Commitments see Simon Lester and Bryan Mercurio, *World Trade Law: Text, Materials and Commentary* (Hart Publishing 2008) 615-616.

> imported or domestic products so as to afford protection to domestic production.[48]

The content of paragraph 1 is developed in the following paragraphs of Article III. For the purpose of this thesis, we will analyse only NT in relation to regulations. Accordingly, Article III(4) reads:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

WTO case-law has developed a three-fold test to assess the consistency of internal regulations with the NT clause of the GATT.[49] According to the DSB it shall be assessed: 1) whether the measure adopted by a WTO member can be considered as a law, regulation or requirement covered by Article III(4); 2) whether the imported and the domestic goods are 'like products'; and 3) whether the adoption of the measure under investigation entails a 'less favourable treatment' of the imported products.[50]

### *3.1.1 The Definition of Measure Covered by Article III GATT*

The first assessment of the test is rather straightforward. Article III(4) refers to 'all laws, regulations and requirements affecting their internal sale, offering for sale, purchase,

[48] Article III(1) GATT.

[49] *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef – Report of the Appellate Body* (11 December 2000) WT/DS161/AB/R [133].

[50] Matsushita, Schoenbaum and Mavroidis (n 46) 133.

transportation, distribution or use'.[51] The broad interpretation of the wording of the clause made by the DSB,[52] and the findings of the previous sections of this chapter,[53] satisfy the first element of the test in case of the Gas Directive.

### *3.1.2 The Likeness Test*

The likeness test echoes the one made above in case of MFN and it is based on the same criteria.[54] An internal regulation affords protection to domestic production only if it addresses domestic and imported products that are in a competitive relationship. The evaluation upon likeness does not depend only on empirical evidence but also takes into account the hypothetical reactions of a reasonable consumer.[55]

For the same reasoning made in paragraph 2.1.2 above, the likeness test of Article III GATT seems to be satisfied in case of the Gas Directive.[56] All in all, we should bear in mind that the concept of 'like product' under Article III(4) has a 'relatively broad scope' and shall be extensively interpreted.[57]

### *3.1.3 The Non-Discrimination Element*

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[51] See also *Italian Discrimination against Imported Agricultural Machineries – Report of the Panel* (23 October 1958) BISD 7S/60 [12].

[52] *United States — Tax Treatment for 'Foreign Sales Corporations' – Report of the Panel* (8 October 1999) WT/DS108/R [10.376]; *Argentina — Measures Relating to Trade in Goods and Services – Report of the Panel* (9 May 2016) WT/DS453/R [7.1015]. See also Gene Grossman, Henrik Horn and Petros Mavroidis, 'The Legal and Economic Principles of World Trade Law' (2012) IFN Working Paper 917/2012, 70.

[53] See sections 2.1.1 and 2.1.4, where we analysed the text of the Gas Directive concerning transportation and distribution services.

[54] See section 2.1.2.

[55] Grossman, Horn and Mavroidis (n 52) 73.

[56] Petros Mavroidis, *The General Agreement on Tariff and Trade: A Commentary* (OUP 2005) 119.

[57] Peter Van den Bossche and Werner Zdouk (n 11) 376.

The third element of the NT test is the non-discrimination assessment of the imported products in comparison to the like domestic ones. In *Korea-Various Measures of Beef* the Appellate Body stated that, although formally non-discriminatory, a measure can still discriminate between like products when it modifies the conditions of competition to the detriment of the imported products.[58]

The Appellate Body subsequently modified its opinion in *Dominican Republic – Import and Sale of Cigarettes*, upholding that:

> The existence of a detrimental effect … resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer.[59]

The two reports above adopted a radically different view on the matter. In *Korea-Various Measures of Beef* the Appellate Body stated that a measure that operates to the detriment of imported goods is always in breach of Article III(4).[60] This is not necessarily the case

[58] In the opinion of the Appellate Body: 'A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III(4). Whether or not imported products are treated 'less favourably' than like domestic products should be assessed instead by examining whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products'. See *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (n 49) [137]. In that case, the Appellate Body reversed the Panel decision whereby 'any regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III(4) of the GATT 1994'. See *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef – Report of the Panel* (31 July 2001) WT/DS161/R [627].

[59] *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes – Report of the Appellate Body* (25 April 2005) WT/DS302/AB/R [96].

[60] *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (n 49) [137].

adopting the *Dominican Republic – Import and Sale of Cigarettes* approach, whereby a measure is illegal only if it discriminates on the basis of the origin of the products.[61]

More recent rulings show that the DSB has not taken a definitive position on the matter. For example, in *Thailand-Cigarettes,* the Appellate Body relied on the precedent *Korea-Various Measures of Beef*, rejecting the complaint of Thailand which, in accordance to the principle underlying *Dominican Republic - Import and Sale of Cigarettes*, argued that the measures at issue were not origin-based and therefore were consistent with Article III(4) GATT.[62] Only one month later, in *US-Clove Cigarettes* the Panel took a step back and interpreted Article III(4) in reference to the view expressed in *Dominican Republic – Import and Sale of Cigarettes.*[63]

In 2014, the Appellate Body intervened again on the matter in the *EC – Seal Products* case, dealing with a legislative scheme adopted by the EU to prohibit the importation and marketing of seal products. In this case, the Appellate Body supported the view of *Korea-Various Measures of Beef*, upholding that under Articles I and III GATT the key issue is whether a measure has a detrimental impact on the competitive opportunities of the imported products.[64]

In sum, it seems that Article III(4) GATT allows distinctions to be drawn, provided that such distinctions do not modify the conditions of competition between imported and like domestic products, irrespective of whether the measure under investigation has actually

[61] Grossman, Horn and Mavroidis (n 52) 70.

[62] *Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines* (n 35).

[63] *United States – Measures Affecting the Production and Sale of Clove Cigarettes – Report of the Panel* (2 September 2011) WT/DS406/R [7.268 - 7.269].

[64] *European Communities – Seal Products* (n 24) [5.94; 5.105; 5.110]. See Michael Ming Du, ‘‘Treatment No Less Favorable’ and the Future of National Treatment Obligation in GATT Article III:4 after *EC–Seal Products 2016*’ 15(1) World Trade Review.

produced a harmful trade effect on the imported goods.[65] We can start from this assumption to assess the Gas Directive *vis-à-vis* Article III GATT.

For our purposes, the analysis of the Panel findings in *Canada – Wheat Exports and Grain Imports* is relevant because the measure under investigation had some points in common with the Gas Directive.[66] The decision of the Panel on Article III(4) has not been appealed, and therefore we can consider it as accepted by the parties. The case was about a Canadian act (the 'Canada Grain Act') requiring an authorisation by a national agency (the 'CGC') as a condition to import foreign grain into the country. Section 57(c) of the Canada Grain Act distinguished between Canadian grain and foreign grain, but it did not impose any less favourable treatment on foreign grain. Moreover, Section 57(c) did not set out neither the criteria to be used by the CGC for granting the authorisation (leaving full discretion to the agency), nor the rules to be followed for foreign companies' application.

In *Canada – Wheat Exports and Grain Imports,* the Panel followed the *Korea – Various Measures of Beef* approach stating that 'by imposing a requirement on foreign grain which is not applicable to like domestic grain, Section 57(c), on its face, treats imported grain less favourably than like domestic grain'.[67]

The Panel adopted a strict view on the less favourable treatment issue, arguing that the simple request for an extra requirement is sufficient to discriminate between domestic and imported products, even though 'the requirement in question may not be very onerous

[65] Grossman, Horn and Mavroidis (n 52) 80. *Japan – Taxes on Alcoholic Beverages – Report of the Appellate Body* (4 October 1996) WT/DS8/AB/R [16] and *United States – Tax Treatment for 'Foreign Sales Corporations' – Report of the Appellate Body* (14 January 2002) WT/DS108/AB/R [215].

[66] *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain – Report of the Panel* (6 April 2004) WT/DS276/R.

[67] Ibid [6.186].

in commercial and/or practical terms'.[68] In the opinion of the Panel, the past attitude of the issuing authority and the simplicity of the application are not sufficient grounds to avoid discrimination.[69] In fact, the Panel did not 'consider that the less favourable treatment […] is removed merely because authorisation under that section may have been consistently granted'.[70]

In our case, the Gas Directive does not exempt European TSOs from being certified under Article 10 to operate in the internal market. However, Article 11 sets out a more burdensome certification process for the TSOs controlled by third country companies which could amount to a less favourable treatment of foreign undertakings in the meaning of *Canada – Wheat Exports and Grain Imports*.

### 3.2 National Treatment under the GATS

Pursuant to Article XVII(1) GATS:

> In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

In addition to that, paragraph 3 specifies that:

[68] Ibid [6.190].

[69] Ibid [6.190 - 6.199].

[70] Ibid [6.200].

> formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

In *EC-Bananas III* the dispute settlement body formulated a three-tier test to assess a breach of the NT under the GATS.[71] Accordingly, we should evaluate 1) whether a country has undertaken specific commitments in the relevant sector or mode of supply; 2) whether the measure at issue is a measure affecting trade in the relevant sector or mode of supply; and 3) whether the measure adopted accords to the services or to the service suppliers of any other Member a less favourable treatment than it accords to the national 'like services' or 'like service suppliers'.[72] This last point requires the analysis both of the 'likeness' and of the 'less favourable treatment' elements.

### *3.2.1 Specific Commitments under the GATS*

Turning to point 1 of the three-tier test, the EU's schedules do not include any service related to gas transmission into the 'positive list' of commitments.[73] This should support the non-applicability of the NT principle to the case at issue. However, the position of three EU countries is likely to cause problems.[74]

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[71] *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Report of the Panel* (22 May 1997) WT/DS27/R [7.314].

[72] Ibid.

[73] See World Trade Organization, 'The European Union and the WTO' (2017) <https://www.wto.org/english/thewto_e/countries_e/european_communities_e.htm> accessed 31 July 2017.

[74] Victor Van Hoorn, 'Unbundling, Reciprocity and the European Internal Energy Market: WTO Consistency and Broader Implications for Europe' (2009) 18 European Energy and Environmental Law Review 72.

Hungary, Lithuania and Croatia made specific commitments in their WTO access schedules in relation to transport services via pipeline or petroleum and natural gas and services incidental to energy distribution.[75] The difference between the commitments made by these countries and the ones made by the EU could be problematic. On the one hand, these countries are obliged to implement the Gas Directive in their territory in accordance with EU law, as they already did.[76] On the other hand, they have to abide by the rules of the WTO, because EU Members are parties to the WTO both separately and together with the EU. Therefore, Hungary, Lithuania and Croatia could be held responsible before a WTO Panel for the breach of NT under the GATS. In view of that, it is useful to carry on our analysis and determine whether the provisions of the Gas Directive comply with NT under the GATS.

### *3.2.2 The Definition of 'Measure Affecting Trade in Services'*

The second element required by the DSB test is the analysis of whether the measure under investigation affects trade in services. For the reasons mentioned in paragraph 2.2.1 above, the Gas Directive satisfies this requirement.

### *3.2.3 Likeness and Non-Discrimination Tests*

[75] See World Trade Organization, 'Hungary – Schedule of Specific Commitments, GATS/SC/40' (1994) <http://www.esf.be/pdfs/GATS%20UR%20Commitments/Hungary%20-%20UR%20Schedule%20of%20commitment.pdf> accessed 31 July 2017; World Trade Organization, 'Lithuania – Schedule of Specific Commitments, GATS/SC/133' (2001) <https://www.wto.org/english/thewto_e/countries_e/lithuania_e.htm> accessed 31 July 2017; World Trade Organization, 'Croatia – Schedule of Specific Commitments, GATS/SC/130' (2000) <https://www.wto.org/english/thewto_e/countries_e/croatia_e.htm> accessed 31 July 2017.

[76] According to the European Commission's website, Hungary, Croatia and Lithuania have implemented the Gas Directive. See European Commission, 'National Transposition' (2017) <https://eur-lex.europa.eu/legal-content/en/NIM/?uri=CELEX:32009L0073> last accessed 28 August 2017.

The last element of the NT test requires the analysis of the 'likeness' of the service or of the service suppliers concerned and the investigation upon discrimination.

In *China-Electronic Payment* the Appellate Body established that the 'core' of 'likeness' analysis is 'the competitive relationship of the services being compared'.[77] In this respect, as seen for Article II GATS, it is likely that the gas transportation companies targeted by the Gas Directive can be considered as like entities.[78]

As mentioned above, 'less favourable treatment' is defined under Article XVII GATS as the different treatment derived from the modification of the conditions of competitions in favour of services or service suppliers of a WTO Member in comparison of services or service suppliers of the other WTO Members. The less favourable treatment can derive from *de facto* discriminatory conducts.[79] The jurisprudence on *Canada – Wheat Exports and Grain Imports*, described in section 3.1 above, can be used in this context.[80] Accordingly, the simple request for an extra requirement to be certified and operate in a market, in our case the European energy market, would influence the conditions of competition of the services or of the service providers concerned. In our case, even if the Gas Directive requires all undertakings willing to operate as TSOs in the EU to be authorised by the relevant national regulatory authority ('NRA'), this path is more 'onerous in commercial and/or practical terms' for third countries' entities.[81]

[77] *China — Electronic Payment Services – Report of the Appellate Body* (16 July 2012) WT/DS413/AB/R [7.702].

[78] See section 2.2.2.

[79] See section 3.2.

[80] See section 3.1.2.

[81] Gas Directive, art 11. See footnote 68.

In the light of the above, it seems that the Gas Directive leads to the less favourable treatment of foreign service suppliers in comparison to domestic ones.

## 4. Quantitative Restrictions

Quantitative restrictions (hereafter, 'QR') are dealt with by Article XI GATT. The prohibition of quantitative restrictions differs from national treatment, because this latter focuses only on the internal requirements that apply to products once they have cleared customs.[82]

Article XI(1) GATT lists four types of quantitative restrictions. First, a quantitative restriction is detected whenever a measure adopted by a WTO member entails a prohibition or a ban of a product. This could be absolute, applying in any circumstance, or conditional, triggered only when certain conditions are fulfilled.[83] Second, GATT prohibits measures imposing a quota on the importation or on the exportation of certain products. This type of restriction can be global (i.e. towards every country), limited to certain geographical areas, or even bilateral, towards one State only. Third, quantitative restrictions could derive from the application of an import/export licensing system. Last, Article XI GATT lays down a catch-all clause which includes all the 'other measures' whose application restricts trade.

As for the other provisions of the GATT, Article XI should be interpreted broadly and extends to all measures 'irrespective of their legal status'.[84] The scope of the term 'restriction' is also broad, meaning 'a limitation on action, a limiting condition or

[82] Matsushita, Schoenbaum and Mavroidis (n 46) 193.

[83] Van Den Bossche (n 14) 444.

[84] Van den Bossche and Zdouk (n 11) 483.

regulation',[85] which can be both *de jure* and *de facto*.[86] It is sufficient that a measure affects the opportunities for importation of a good to breach Article XI.[87]

The prohibition of QR set out under paragraph 1 is not absolute. WTO Members can derogate from it in the cases outlined in paragraph 2.[88] In any event, the eventual quantitative restrictions set out shall be administered in a non-discriminative manner.[89]

In *India – Measures Affecting the Automotive Sector*, the Panel set out a three-tier test to assess the compliance of a regulation with Article XI(1) GATT. Accordingly, it shall be verified whether the measure under investigation: (i) is a government 'measure'; (ii) is different from a 'duty, tax or other charge' and falls within the definition of quotas, licences or other measures; and (iii) 'restricts' the importation of a good.[90]

As for the first element of the test set out in *India – Measures Affecting the Automotive Sector*, the Gas Directive certainly falls within the scope of the term 'measure'.[91] Besides,

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[85] World Trade Organization, *Dispute Settlement Reports 2009: Volume 6, Pages 2533-2908* (CUP 2009) 2731.

[86] *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins – Report of the Panel* (25 January 1990) BISD 37S/86 [150]; *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather – Report of the Panel* (19 December 2000) WT/DS155/R [11.17].

[87] *Dominican Republic – Sale of Cigarettes* (n 59) [7.261].

[88] These cases are: (a) export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party; (b) import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade; (c) import restrictions on any agricultural or fisheries product, imported in any form, necessary to the enforcement of governmental measures which operate. The Gas Directive does not fall within any of the cases above.

[89] Simon Lester, Bryan Mercurio and Arwel Davies, *World Trade Law: Text, Materials and Commentary* (2nd edn, Hart Publishing 2012).

[90] *India – Measures Affecting the Automotive Sector – Report of the Panel* (21 December 2001) WT/DS146/R [4.119]. In *India – Automotive Sector* the Panel summarised in three points the test previously set out in *Japan – Trade in Semi-Conductors – Report of the Panel* (24 May 1988) BISD 35S/116 [104-123].

[91] See section 2.2.1 above.

as regards item (ii), the Gas Directive does not 'take the form of duties, taxes or other charges'.

Focusing on the positive list of measures referred to under the second element of the test, quantitative restrictions shall be made effective through quotas, import/export licences or other measures which potentially affect the opportunities for importation of natural gas.

There are few WTO cases dealing with import quotas.[92] These refer to measures expressed quantitatively that differ from the Gas Directive since they impose direct or indirect caps on the importation of a product.

As regards to import-licenses (the only type of licence which could be applied to the case at issue), these are defined under Article 1 of the Agreement on Import Licensing Procedures as: 'administrative procedure[s] requiring the submission of an application […] to the relevant administrative body as a prior condition for importation in the customs territory of the importing member'. As seen above, even though the Gas Directive does not directly regulate natural gas as a good, it could have a potential impact on its importation from non-EU countries.[93] Therefore, the certification process set out under the Gas Directive could fall within the import-licence category.

The 'other measures' of Article XI have been interpreted in *Colombia – Ports of Entry* as a residual category that may take any form.[94] These measures have been identified in case

[92] *France - Import restrictions - Report of the Panel* (14 November 1962) BISD 11S/94; *Japan — Restrictions on Imports of Certain Agricultural Products – Report of the Panel* (2 March 1988) BISD 35S/163; *United States - Restrictions on Imports of Sugar United – Report of the Panel* (22 June 1989) BISD 36S/331.

[93] See section 2.1.4.

[94] *Colombia - Indicative Prices and Restrictions on Ports of Entry – Report of the Panel* (27 April 2009) WT/DS366/R [7.227]. The same interpretation of the expression 'other measures' has been reiterated in *Argentina-Measures Affecting the Importation of Goods.* See *Argentina – Measures Affecting the Importation of Goods – Report of the Panel* (22 August 2014) WT/DS438/R [6.248]. See also Trebilcock, Howse and Eliason (n 11) 281.

of import or export prohibitions,[95] import/export minimum price systems,[96] state-trading operations,[97] and import/export restrictions.[98] Considering the broad interpretation of the expression adopted by the DSB and its all-encompassing nature, the Gas Directive could also fall within the 'other measures' of Article XI GATT.

The third element of the test outlined in *India – Measures Affecting the Automotive Sector* requires the investigation over the existence of an import restriction. This could be actual as well as potential, both *de jure* and *de facto*.[99] In *Colombia – Ports of Entry* the Panel stated that the design, the structure and the architecture of a measure are sufficient to breach Article XI.[100] In the Panel's view, 'measures which create uncertainties and affect investment plans, restrict market access for imports or make importation prohibitively costly' fall under the scope of Article XI.[101] This confirmed the views expressed by previous Panels which outlawed measures having implications on the competitive situation of an importer.[102] In particular, in *India-Automotive* the Panel identified a quantitative restriction in the case of products allowed into the market under certain

[95] *United States – Manufacturing Clause – Report of the Panel* (15 May 1984) BISD 31S/74; *United States – Restrictions on Imports of Tuna – Report of the Panel* (unadopted) WT/DS29/R.

[96] *Japan – Trade in Semi-Conductors* (n 90).

[97] *Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies – Report of the Panel* (22 March 1988) BISD 35S/37-98.

[98] The Report of the Working Party on 'the Use of Quantitative Restrictions for Protective and Commercial Purposes', adopted on 7 November 1989, lists under paragraphs 114-115 several types of import and export restrictions.

[99] Van den Bossche and Zdouk (n 11) 484. See *Argentina – Hides and Leather* (n 86) [11.17]. In this case, the Panel supported the applicability of Article XI GATT to *de facto* measures based on *Japan – Trade in Semi-Conductors* (n 96) [105-109]. The same view has been reiterated in *Colombia - Ports of Entry* (n 94) and *China – US Poultry* (n 16).

[100] *Colombia - Ports of Entry* (n 94) [7.589].

[101] Ibid [7.240].

[102] Ibid.

conditions which made the importation more onerous, generating a disincentive to invest, without the need to set a cap on imports.[103] The same Panel, recalling the *Japan-Semiconductors* ruling, stated that a non-automatic licensing procedure – such as the Gas Directive – constitutes a restriction on the importation prohibited under Article XI.[104]

In light of the foregoing, the Gas Directive could restrict natural gas trade in the meaning of Article XI GATT.

## 5. Market Access Barriers to Services

Market access barriers to services are dealt with under Article XVI(1) GATS. Accordingly:

> With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.

WTO case-law did not set out any test applicable in the case of Article XVI. Therefore, we can apply by analogy the criteria outlined by the DSB to similar circumstances.[105]

As for the NT obligations, market access rules under the GATS depend only on the commitments made by the single countries in their Schedules of Specific

[103] *India – Automotive* (n 90) [7.269].

[104] Ibid [5.130]. *Japan – Trade in Semi-Conductors* (n 96) [118]. World Trade Organization, *WTO Analytical Index 2 Volume Set: Guide to WTO Law and Practice* (CUP 2007) 214.

[105] See Lode Van der Hende and Herbert Smith, 'GATS Article XVI and National Regulatory Sovereignty: What Lessons to Draw from *US-Gambling?*' in Alexander Kern and Mads Tønnesson, *The World Trade Organization and Trade in Services* (2008 Martinus Nijhoff Publishers).

Commitments.[106] These represent a minimum standard of openness WTO members have to guarantee. However, unlike NT, market access prohibits only a limited number of conducts listed under Article XVI(2).[107]

Market access under the GATS covers both discriminatory and non-discriminatory conducts that restrict trade in services.[108] Differently from Article XI GATT, not every limitation listed under Article XVI is quantitative.[109] However, as for quantitative limitations, market access barriers do not only refer to measures that set out numerical quotas but also to those that cover actions that have a similar effect to a numerical quota.

As for NT under the GATS, the European Union did not set out any market access commitment in relation to (i) services incidental to mining, rendered on a fee or contract basis at oil and gas fields; (ii) services incidental to energy distribution; or (iii) transportation via pipeline of crude or refined petroleum and petroleum products and of natural gas.[110] These are the only schedules of the GATS dealing with energy

[106] World Trade Organization, *A Handbook on Reading WTO Goods and Services Schedules* (CUP 2009) 34.

[107] These are: (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test; (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test; (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment. The *chapeau* of Article XVI(2) specifies that the restrictions above are to be intended as an exclusive list.

[108] *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services – Report of the Appellate Body* (7 April 2005) WT/DS285/AB/R [214 – 248]; Panagiotis Delimatsis, *International Trade in Services and Domestic Regulation: Necessity, Transparency and Regulatory Diversity* (OUP 2007) 134.

[109] For instance, letter e) refers to the legal form of incorporation.

[110] See World Trade Organization, 'The European Union and the WTO' (2017) <https://www.wto.org/english/thewto_e/countries_e/european_communities_e.htm> accessed 31 July 2017.

transportation. Therefore, in principle the EU does not have the obligation to guarantee any market access standard to third countries' undertakings willing to invest in European TSOs. However, for the same reasons outlined in the NT section, the position of Hungary, Lithuania and Croatia is likely to cause problems. These countries made commitments under items (ii) and (iii) above. If the Gas Directive was in breach of the market access rules, its implementation in Hungary, Lithuania and Croatia would violate the three countries' obligations under the GATS. For this reason, we will assess the Gas Directive *vis-à-vis* Article XVI GATS, in particular against letters a), e) and f) of Article XVI(2). These are the most relevant clauses applicable to the case at hand.

### 5.1 Article XVI(2)(a)

As mentioned in previous sections, the Gas Directive impacts on 'service suppliers' within the meaning of the GATS.[111] Pursuant to Article XVI(2) a service suppliers' limitation could be achieved in different ways. Letter (a) indicates the adoption of numerical quotas, monopolies, the presence of exclusive service suppliers and the request for an economic needs test.[112] For our purposes, the most relevant option to be investigated is numerical quotas.

In *China – Electronic Payment Services* the Panel stressed that, when assessing the consistency of a measure with Article XVI(2)(a) of the GATS, the focus must be on whether the measure at issue 'constitute[s] a limitation that is numerical and quantitative

[111] See sections 2.2 (on MFN) and 3.2 (on NT).

[112] United Nations Conference on Trade and Development, 'Lists of Economic Needs Tests in the GATS Schedules of Specific Commitments' (1999) <http://unctad.org/en/docs/poitcdtsbd8.pdf> accessed 31 July 2017.

in nature' or acts 'as a quota would do', and not on whether it 'formally or explicitly institute[s] a monopoly or an exclusive service supplier'.[113]

Similarly, in *US-Gambling* the Panel stated that 'a measure that is not expressed in the form of a numerical quota or economic needs test may still fall within the scope of Article XVI(2)(a)'.[114] The case dealt with a US government's provision which prohibited the cross-border supply of gambling services. This was interpreted by the Appellate Body as *de facto* being a quantitative restriction – leading to a zero quota – and thus numerical in nature, even if the American legislator did not set out any express limitation in number or percentage.[115]

In principle, the Gas Directive seems to have different characteristics from those outlined in *US-Gambling*. In fact, it neither imposes a blank prohibition nor it sets out a well-determined number of foreign service suppliers authorised to operate in Europe. Therefore, it leads neither to a zero quota nor to a precise numerical limitation of the service suppliers. A different interpretation would stretch the wording of the clause beyond recognition.

Similarly, the possibility of choosing one out of three different unbundling models is not an issue under the GATS. No WTO rule sanctions the disadvantage put on undertakings due to the adoption of an internal measure that does not discriminate between the regulated subjects. In the light of the above, the Gas Directive seems to comply with Article XVI(2)(a) of the GATS.

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[113] *China – Electronic Payment Services – Report of the Panel* (16 July 2012) WT/DS413/R [7.592].

[114] *US – Gambling* (n 108) [6.332].

[115] Ibid [227].

### 5.2 Article XVI(2)(e)

As regards letter e),[116] the Gas Directive does not impose the adoption of any kind of legal entities to operate in the internal market,[117] nor it expressly requires the setup of joint ventures to provide transportation services. However, as seen in chapter II, Article 11 of the Gas Directive *de facto* demands third countries' suppliers and producers to participate with other entities in EU TSOs to comply with the EU unbundling rules.[118] A previous experience in the natural gas field is not a mandatory requirement to participate in European TSOs: even institutional or private investors could set up transportation companies with third countries' entities.

The GATS does not outline any definition of 'joint venture'. This can be defined as 'a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity'. [119] Accordingly, the construction and/or the management of a TSO could fall within the definition of joint venture, since Article 11 requires the agreement of the third country supplier/producer with at least another company which could control

[116] For the text of the provision refer to footnote 107.

[117] The term 'legal entity' is not defined in the GATS. According to the Oxford English Dictionary, an 'entity' is defined as '[e]xistence, being, as opposed to non-existence; the existence of a thing as opposed to its qualities or relations' or 'an organisation (as a business or governmental unit) that has an identity separate from those of its members'. The term 'legal' means '[o]f or pertaining to law; falling within the province of law'. Continuing our textual analysis with the phrase 'specific types of' which precedes the phrase 'legal entity', the adjective 'specific' means '[c]learly or explicitly defined; precise, exact; definite'. The noun 'type' is defined as '[a] class of people or things distinguished by common essential characteristics; a kind, a sort'. Hence, based on the ordinary meaning of relevant terms, Article XVI(2)(e) appears to cover measures which restrict or require clearly defined kinds of organisation falling within the province of law.

[118] See chapter II, section 4.

[119] Investopedia defines a Joint Venture as a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity. In a joint venture, each of the participants is responsible for profits, losses and costs associated with it. However, the venture is its own entity, separate and apart from the participants' other business interests'. Source: Investopedia, 'Joint Venture' (2015) <https://www.investopedia.com/terms/j/jointventure.asp> accessed 12 April 2017.

the relevant TSO in the meaning of the EU Merger Regulation.[120] Under the Gas Directive, a joint venture can refer to a new project, for example the construction of new interconnectors (for which ownership unbundling is mandatory),[121] or to 'any other business activity' (for which States can choose one of three unbundling models).

The interpretation of the Gas Directive as *de facto* requiring non-EU entities to set up a joint venture is in line with the broad meaning WTO case-law tends to give to the clauses of WTO agreements.[122] Normally, the requirement to set up a joint venture to enter a market reflects the need of the regulatory authority to foster the transfer of technology and know-how to domestic companies.[123] This is not the case under the Gas Directive. The reason to impose the adoption of a joint venture is the need to enhance competition in the internal market by decreasing the negative effects caused by the dominance of third countries' suppliers. Article XVI does not outline any exception to the prohibition to invest through joint ventures. Hence, the Gas Directive seems to breach Article XVI(2)(e) GATS.

### 5.3 Article XVI(2)(f)

Article XVI(2)(f) GATS prohibits limitations on the participation of foreign capital in terms of maximum percentage limits on foreign shareholding or of the total value of individual or aggregate foreign investments.[124] As an example of the measures covered

[120] Council Regulation (EC) 139/2004 on the Control of Concentrations between Undertakings (Merger Regulation) [2004] OJ L24/1, Article 3(1).

[121] See chapter II, section 2.

[122] We have already seen in sections 3.1.2 and 4 of this chapter that the WTO adjudicative body tends to interpret the wording of the WTO agreements very broadly.

[123] Rüdiger Wolfrum and Peter-Tobias Stoll, *WTO – Trade in Services* (2008 Martinus Nijhoff Publishers) 388.

[124] *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products – Report of the Panel* (12 August 2009) WT/DS363/R [7.1360].

under letter f), the 2001 Scheduling Guidelines include provisions imposing a percentage cap on the corporate capital of the invested company.[125] No other indication is given about the other forms of limitation on foreign equity participation and no Panel has ever tackled this issue so far.

The Gas Directive uses the definition of control under the Merger Regulation to regulate the application of the unbundling rules. Accordingly, 'control' generally relates to the exercise of a decisive influence on the decisions of a company.[126] This is not always expressed in terms of equity percentage and it could derive also from what has been agreed on in the articles of incorporation and in the by-laws of the company. Even if control can derive from situations which do not relate to equity participation, this is the first index to be examined. Indeed, no majority shareholder would leave its company in the hands of the administrators representing the minority, relinquishing its property rights over the company owned. The possibility to exercise a decisive influence through means other than equity participation, such as veto rights, is usually limited to well-determined issues to be agreed on by the shareholders – e.g. decisions exceeding the ordinary administration – and can derive from the participation of State-controlled entities to the corporate capital of the invested company.[127]

On the basis of the definition laid down under the Merger Regulation, there can be more than one entity exercising the control over a company at the same time. For example, company A could exercise control over Company B through veto rights, while company

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[125] World Trade Organization, 'Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS)' (2001) 5 <https://i-tip.wto.org/services/> last access 9 April 2015.

[126] Merger Regulation (n 120) 3.

[127] See Case C-58/99 *Commission of the European Communities v Italian Republic. - Privatisation of Public Undertakings - Grant of Special Powers* [2000] ECR I-3811.

C could control B by virtue of equity participation.[128] Notably, in case of public companies – a category which typically includes natural gas TSOs – a small equity participation can lead to the control when the rest of the shares are spread over a great number of small shareholders.

Hence, we cannot refer to predetermined caps in relation to the whole corporate capital of the undertakings concerned to identify a limitation on foreign equity participation under the Gas Directive. However, despite the DSB did not expressly rule on the matter, Article XVI(2)(f) GATS should be applicable also to this case. This is justified by reasoning made by the Appellate Body in *US-Gambling*, where it found that a measure not expressed in numerical form could *de facto* lead to practical results similar to the ones covered by Article XVI.[129]

Turning to the text of Article XVI(2)(f) we observe that the 'capital', the participation of which is subject to a limitation is preceded by the word 'foreign'. Moreover, the two forms which a measure falling under this provision may take are also qualified by the word 'foreign' ('foreign share-holding' and 'foreign investment'). Consistent with the principle of effective treaty interpretation, the word 'foreign', which is used three times in Article XVI(2)(f), must be given meaning and effect.

The ordinary meaning of 'foreign' is '[b]elonging to, coming from, or characteristic of, another country or nation'.[130] The ordinary meaning of the word 'foreign' indicates that

[128] According to the European Commission 'Article 3(1)(b) provides that a concentration occurs in the case of an acquisition of control. Such control may be acquired by one undertaking acting alone or by several undertakings acting jointly'. See: European Commission, 'Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the Control of Concentrations Between Undertakings' (2008) 5 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:095:0001:0048:EN:PDF> last access 9 April 2017.

[129] *US – Gambling* (n 108) [238-251]. In para 227 of the same decision, the Appellate Body extended the applicability of Article XVI to *de facto* measures.

[130] A Stevenson (ed.), *Shorter Oxford English Dictionary* (6th edn, OUP 2007) 1015.

Article XVI(2)(f) covers limitations on the participation of capital 'belonging to', or 'coming from' another country or nation. Similarly, the share-holding whose maximum percentage level may be limited, as well as the individual or aggregate investment whose total value may also be limited within the meaning of Article XVI:2(f) 'belongs to' or 'comes from' another country or nation.

Hence, Article XVI(2)(f) does not cover origin-neutral limitations, i.e. those measures applying without distinction to foreign and domestic capital participation are not covered by this provision. Under this perspective, the unbundling provisions of Article 9 of the Gas Directive equally apply to domestic and foreign undertakings, prohibiting both EU and extra-EU producers and suppliers from controlling EU TSOs. Once a Member States transposes the Gas Directive in its territory, the unbundling regime chosen equally applies to domestic and foreign companies operating in the country.

For the reasons above, the Gas Directive does not seem to breach Article XVI(2)(f) GATS.

## 6. General Exceptions

This section addresses the possibility to apply the 'general exceptions' included under the GATT (Article XX) and the GATS (Article XIV) to justify the breaches of the WTO rules made by the Gas Directive we outlined in the previous sections of this chapter. We will assess letter d) to Article XX and letters a) and c) to Article XIV, since these are the only clauses which could be relevant for our purposes.[131]

[131] Pursuant to Article XX GATT: 'Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of

The Appellate Body determined the applicability of Article XX case-law for the interpretation of Article XIV GATS because of the 'similar language used in both provisions, notably the term 'necessary' and the requirements set out in their respective *chapeau'*.[132] The *chapeau* comes into play only when a measure inconsistent with one of the two agreements falls within one of the cases listed under the general exceptions.[133]

We will start with the analysis of Article XIV(a) GATS. Afterwards, Article XX(d) GATT and Article XIV(c) GATS will be analysed jointly, because of their similar wording.[134]

### 6.1 Compliance with Article XIV(a) GATS

Article XIV(a) demands that the measure under investigation shall be necessary for the protection of the public morals or the maintenance of public order.[135] The necessity of the

monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices'. Pursuant to article XIV GATS:' Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (a) necessary to protect public morals or to maintain public order; (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to: (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts; (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts; (iii) safety.

[132] *US — Gambling* (n 108) [291], pursuant to which 'Both of these provisions [Articles XX GATT and XIV GATS] affirm the right of Members to pursue objectives identified in the paragraphs of these provisions even if, in doing so, Members act inconsistently with obligations set out in other provisions of the respective agreements, provided that all of the conditions set out therein are satisfied. Similar language is used in both provisions, notably the term 'necessary' and the requirements set out in their respective *chapeaux*. Accordingly, like the Panel, we find previous decisions under Article XX of the GATT 1994 relevant for our analysis under Article XIV of the GATS'.

[133] *United States — Standards for Reformulated and Conventional Gasoline – Report of the Appellate Body* (29 April 1996) WT/DS2/AB/R [22].

[134] Both agreements allow contracting parties to adopt measures 'necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement [at issue]'.

[135] *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services – Report of the Appellate Body* (10 November 2004) WT/DS285/R [6.455].

measure taken, element in common with Articles XIV(c) GATS and XX(d) GATT, will be analysed in section 6.3 below. In this section, we will focus on the other aspects of Article XIV(a) and, specifically, on the definition of 'public order'. We will leave apart the expression 'public moral', which does not seem to be a pertinent element in the case at hand.

The Appellate Body in *US — Gambling* took the same view of the Panel, which concluded that the expression 'public order', combined with footnote 5 of Article XIV(a) 'refers to the preservation of the fundamental interests of a society, as reflected in public policy and law. These fundamental interests can relate, *inter alia*, to standards of law, security and morality'.[136]

In the case under consideration, the first element to be assessed is whether the provisions of the Gas Directive breaching the GATS can be justified on the basis of a social interest and, in particular, under a 'standard of security'. This is quite an ambiguous formulation. However, considering the strategic importance of the field, it is likely that the notion of public order as a security standard includes the safeguard of EU security of supply.[137] Moreover, the Appellate Body used the periphrasis '*inter alia*', meaning that the fundamental interests of the society reported are not to be intended as an exclusive list. For these reasons, we can conclude that the EU could easily justify the application of the Gas Directive as a measure aimed at maintaining the public order. In the legal doctrine,

[136] *US — Gambling* (n 135108) [6.467]. Footnote 5 reads: 'The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society'.

[137] Please refer to Section 7 of this chapter where we illustrate the security reasons underlying the adoption of the Gas Directive.

the interpretation of 'public order' as potentially covering the access to essential facilities – such as gas pipelines – is supported by Cottier.[138]

In addition to the above, we shall examine whether trade in transportation services impairs or jeopardizes the achievement of the policy objective at stake, in compliance with footnote 5 which requires to identify a 'genuine and sufficiently serious threat'.[139] This shall be distinguished from the Member's right to determine its own level of protection (e.g. zero-risk level), which primarily relates to the adequacy of a given measure in relation to the level of protection chosen by the WTO Member adopting it.[140]

The standard for determining whether a threat is 'genuine and sufficiently serious' has not been explicitly addressed so far. In light of this, we consider it useful to begin with some general considerations regarding the interpretation of these terms, following the principles of treaty interpretation in Article 31 of the Vienna Convention on the Law of Treaties. We begin by noting that the term 'threat' is defined in the Shorter Oxford English Dictionary as 'an indication of the approach of something unwelcome or undesirable; a person or thing regarded as a likely cause of harm'.[141] With respect to the meaning of a 'sufficiently serious' threat, we note that the term 'sufficiently' is defined in the Shorter Oxford English Dictionary as 'in a sufficient manner; adequately, satisfactory, enough',[142] whereas the term 'serious' is defined as '[i]mportant, grave; having (potentially) important, esp. undesired, consequences; giving cause for concern;

[138] Thomas Cottier, Panagiotis Delimatsis and Nicolas Diebold, 'Article XIV: General Exceptions' 9 <http://ssrn.com/abstract=1280215> accessed 20 May 2015.

[139] See footnote 136.

[140] Wolfrum, Stoll and Feinäugle (n 123) 302.

[141] A. Stevenson (ed), *Shorter Oxford English Dictionary* (6th edn, OUP 2007) 3248.

[142] Ibid 3097.

of significant degree or amount; worthy of consideration'.[143] In this light, for a threat to be considered sufficiently serious within the meaning of footnote 5, the potential consequences or effects on the fundamental interest of society must be of a certain magnitude or gravity. As for the meaning of a 'genuine' threat, we note that the term 'genuine' is defined in the Shorter Oxford English Dictionary as '[h]aving the character claimed for it; real, true, not counterfeit'.[144]

In light of the above, a literal interpretation of footnote 5 seems to require the presence of two elements to satisfy Article XVI(a): the degree of threat (i.e. the measure adopted must contrast a substantial negative effect of the trade in service) and the timing (i.e. the threat must be present at the time in which the measure was adopted). These two conditions do not seem to be present in the case of the Gas Directive. Focusing on the second element of footnote 5, the Gas Directive was adopted two years after the Energy Sector Inquiry.[145] This latter was completed one year after the first gas war between Russia and Ukraine, which took place in 2006. The fact that the second gas war took place in 2009, the same year of the adoption of the Gas Directive, is not a pertinent argument. The Gas Directive had been under discussion since 2007 and its adoption was not related to the second gas shortage. In this light, the second requirement of footnote 5 is not met. Furthermore, as regards the first element of footnote 5, it is arguable that the situation in which the most important supplier of natural gas to the EU owns several EU pipelines constitutes a 'genuine and sufficiently serious threat' to the internal security of supply of the Union.[146] In addition to that, the measures included under the Gas Directive breaching the GATS

[143] Ibid 2762.

[144] Ibid 1094.

[145] See Chapter I, section 6.1.

[146] Section 7 (Security exceptions) outlines four reasons which explain why Gazprom cannot be considered as a danger for EU security of supply.

may eventually improve competition in the energy market, but they do not seem to be directly applicable on their own to face a sudden gas scarcity. In particular, Article 11 of the Gas Directive, setting out discretionary procedures for foreign companies' certification, does not seem to be able to contrast a substantial negative effect of trade as required by Article XIV(a). For the reasons above, the Gas Directive does not seem to comply with Article XIV(a) GATS.

### 6.2. Compliance with Article XIV(c) GATS and Article XX(d) GATT

Article XIV(c) GATS and Article XX(d) GATT demand the assessment of a three-tier test.[147] Pursuant to the Panel in *US-Gambling*, the WTO Member invoking these justifications shall demonstrate that (i) the measure under investigation is designed to secure compliance with national laws or regulations; (ii) the national laws or regulations referred to are not inconsistent with the agreement invoked; (iii) the necessity test is satisfied.[148] This last element, in common with Article XIV(a) GATS, will be analysed in section 6.3 below.

[147] Pursuant to Article XX GATT: 'Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices'. Pursuant to article XIV GATS:' Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to: (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts; (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts; (iii) safety.

[148] *US — Gambling* (n 108) [6.536].

The terms 'laws' and 'regulations' refer not only to rules that form part of the domestic legal system of a WTO Member,[149] but also to international law rules which apply domestically by virtue of implementation or through direct effect.[150] National competition laws may be covered by this paragraph, provided that they are *per se* GATT/GATS consistent.[151]

In the case at hand, the EU could argue that the Gas Directive has been adopted to achieve the objectives set out in Articles 101 and 102 of the TFEU in a market characterised by several anticompetitive practices. These articles prohibit antitrust restrictive practices and the abuse of dominant position in the internal market. From the EU perspective, there is no doubt that these are 'rules that form part of the domestic legal system of a WTO Member',[152] since Articles 101 – 102 are two founding principles of European competition law. The Gas Directive clearly reflects the scope of those two articles and their aim of enhancing competition in view of finalising the internal market, one of the objectives of the EU itself.[153] Reference to competition law is made several times in the Gas Directive, since its preparatory works and the first recitals, and it is clear that from a competition law perspective the Gas Directive pursues the final objectives of the

[149] *Mexico — Tax Measures on Soft Drinks and Other Beverages - Report of the Appellate Body* (6 March 2006) WT/DS308/AB/R [70-77].

[150] Ibid [69].

[151] Cottier, Delimatsis and Diebold (n 138).

[152] *Mexico — Tax Measures* (n 149) [70]. The list of matters reported under Article XX(d) (customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices) is merely indicative. See Van den Bossche and Zdouk (n 11) 562.

[153] Article 3 TEU.

Treaty.[154] Enhancing competition is also in line, and thus not inconsistent, with the final aims underlying GATT and GATS.[155]

In *Mexico — Tax Measures*, the Appellate Body underlined that a measure [e.g. the Gas Directive] 'secures compliance' with another [e.g. Articles 101 – 102 TFEU] even if it 'cannot be guaranteed to achieve its result with absolute certainty'.[156] Hence, measures which contribute to securing compliance with laws or regulations that are not inconsistent with the WTO rules fall within the application of Articles XIV(c) GATS and XX(d) GATT.[157] However, in *US-Gambling* the Appellate Body specified that the measure for which justification is sought has to 'enforce obligations' contained in the laws and regulations to which reference is made and not merely 'ensure achievement of the goals' underlying those laws and regulations.[158] Under this perspective, it seems difficult to maintain that the Gas Directive 'secures compliance' with Articles 101 and 102 TFEU. Indeed, the provisions of the Gas Directive breaching the GATT and the GATS do not seem to directly enforce the rules of the Treaty (Articles 101 and 102 prohibit certain types of anticompetitive conducts and the abuse of dominant position of the undertakings operating in the EU market). Instead, by imposing rules on impartial access to the natural monopoly and on the independence of the transmission operators (i.e. unbundling), the Gas Directive modifies the energy market structure and the business structure of the

[154] Gas Directive, recitals No 5, 8, 16, 17, 25, 33, 35, 42, 44, 47, 54.

[155] Mitsuo Matsushita, 'Basic Principles of the WTO and the Role of Competition Policy' (2004) 3 Washington University Global Studies Law Review 364.

[156] *Mexico — Tax Measures* (n 149) [74].

[157] Ibid.

[158] *US — Gambling* (n 108) [345].

undertakings concerned in a way to prevent the possible abuse of dominant position by former incumbents.

The same reasoning above applies to Article 95 of Treaty of the European Community ('Approximation of Laws'), expressly mentioned as the legal basis for the adoption of the Gas Directive.[159]

### 6.3 The Necessity Test

The analysis of the 'necessity' of the measure taken, a common element to the articles analysed in the previous sub-sections, requires the study of Article XX GATT case-law,[160] and, in particular, of the 'weighing and balancing' process described in *Korea – Various Measures on Beef* and subsequently reaffirmed in several cases, among which is *EC – Asbestos.*[161]

This process begins with an assessment of the 'relative importance' of the interests or values furthered by the challenged measure. Having ascertained the importance of the interests at stake, a panel should then turn to the other factors that are to be 'weighed and balanced'. The Appellate Body has pointed out two factors that, in most cases, will be relevant for this exercise. One factor is the restrictive impact of the measure on

[159] This is outlined in the first lines of the Gas Directives. As we will see in chapter IV, the legislation issued after the Lisbon Treaty with impact on the energy field is justified on the basis of the new Article 194 TFEU.

[160] *US — Gambling* (n 108) [556].

[161] *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (n 49) [178] and *EC – Asbestos* (n 17) [172]. Other cases in which the DSB followed the approach of *Korea – Various Measures on Beef* are: *Dominican Republic –Import and Sale of Cigarettes* (n 59), *Colombia Ports of Entry* (n 99) and *United States — Import Prohibition of Certain Shrimp and Shrimp Products – Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R.

international commerce; the other factor is the contribution of the measure to the realisation of the ends it pursues.[162]

After the weighing and balancing, a comparison between the challenged measure and the possible alternatives should then be undertaken, and the results of such comparison should be considered in light of the importance of the interests pursued.[163] It is on this basis that a panel determines whether a measure is 'necessary' or, alternatively, whether another WTO-consistent measure is 'reasonably available'.[164]

In this respect, the alternative measure should be an appropriate means to achieve the desired level of protection which a Member has unilaterally defined.[165] The Appellate Body underlined that 'an alternative measure may be found not to be 'reasonably available' […] where it is merely theoretical in nature, imposes prohibitive costs or substantial technical difficulties'.[166]

Necessity is a flexible concept.[167] In *Mexico – Taxes on Soft Drinks*, the Appellate Body underlined that a measure can still be regarded as necessary even if it does not guarantee the achievement of the ends sought with absolute certainty.[168] The fact that the general design of the challenged measure contributes to the achievement of the ends pursued

[162] See *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (n 49) [162-164].

[163] *US — Gambling* (n 108) [307].

[164] Ibid. According to Klamer, the necessity test 'seems to entirely exempt indispensable national measures from scrutiny and assesses only such measures as are 'necessary' to a lesser degree'. See Marcus Klamer, *Services Liberalisation in the EU and the WTO* (CUP 2015) 33.

[165] *US — Gambling* (n 108) [308].

[166] Ibid [308].

[167] Wolfrum, Stoll and Feinäugle (n 123) 316.

[168] *Mexico — Tax Measures* (n 149) [74]. See also *United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services – Report of the Panel* (7 April 2005) WT/DS285/R [6.494].

would suffice.[169] In the case of a high level of protection chosen by the respondent, an outright prohibition may be considered as a measure 'clearly designed and apt to achieve' the level of protection desired.[170]

In case of a WTO dispute, the EU should put forward all the elements which would define the Gas Directive – and in particular Articles 9 and 11 – as 'necessary' for the defence of its public order (Article XIV(a) GATS, analysed in section 6.1 above) or to comply with internal competition rules (Articles XIV(c) GATS, XX(d) GATT, analysed in section 6.2 above).[171] Eventually, the EU could even underline the reasons why the alternative measures would not be viable or would not achieve the same results. However, it would be under no obligation to do so. This would be the case only if Russia could demonstrate the existence of less restrictive alternative measures against its undertakings.

The possibility of engaging in bilateral or multilateral consultations would not be *per se* sufficient to demonstrate the existence of alternative measures available. In fact, consultations are 'a process, the results of which are uncertain and therefore not capable of comparison with the measures at issue'.[172] Failure to identify an alternative reasonable measure by the claimant would qualify as 'necessary' the action taken by the respondent.

To contest the applicability of Article XIV GATS and Article XX GATT to the case at issue, Russia should propose a reasonably available alternative measure to the adoption of the third country clause. This does not seem to be a difficult exercise, above all when considering the 'restrictive impact of the measure on international commerce' and the

[169] Ibid.

[170] *EC – Asbestos* (n 17) [168].

[171] In the case at hand, the EU could support the necessity of Articles 9 and 11 based on security of supply reasons. See section 7 for an in-depth explanation.

[172] *US — Gambling* (n 108) [322].

'contribution of the measure to the realisation of the ends it pursues' elements of the weighing and balancing process. Indeed, as shown above in this chapter, the Gas Directive significantly endangers trade of goods and services between the EU and Russia mandating the modification of the business structure of the undertakings concerned in breach of several GATT and GATS clauses. Moreover, as underlined in Chapter II, the Gas Directive does not seem to be the best way to contribute to the realisation of the security interests pursued by the EU.[173]

So far, the Gas Directive does not seem to comply with the elements required by Article XIV(a) and (c) GATS and Article XX(d) GATT. In any event, even assuming that it does, the Gas Directive should comply with the *chapeau* of the two Articles to be justified under the general exceptions of the GATS and of the GATT.

### 6.4 Compliance with the *Chapeau*

The first paragraph of Article XIV GATS and of Article XX GATT – so-called *chapeau* – sets out that a measure in breach of the agreements which falls within the application of Article XIV or of Article XX, shall not be in any case adopted as 'a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or as a disguised restriction on trade'.

The wording of the provision may suggest that some discrimination may be tolerated, as long as that cannot be labelled as 'unjustifiable' or 'arbitrary'.[174] In *US – Shrimp*, the combination of several factors led the Appellate Body to conclude that there was

[173] See chapter II, section 5.

[174] *Argentina – Hides and Leather* (n 86) [11.315].

'unjustifiable' discrimination.[175] First, the United States unilaterally applied its import prohibition without engaging in negotiations with some Members, while it did negotiate with others.[176] Moreover, the fact that different countries were accorded different periods of time for phasing in compliance with the measure in question also constituted differential treatment among the various countries seeking certification.[177] Furthermore, the United States discriminated with regard to the different effort needed to transfer the technology necessary to achieve compliance with its measure.[178] In *Brazil - Tyres*, the Appellate Body went one step further, and held that rather than the effect, it is the rationale of the discrimination that should determine the *chapeau* analysis.[179] This new criterion hinges on the policy objective of the measure, rather than looking at whether the measure is applied in a 'rigid' or 'unilateral' manner, standard applied by the Appellate Body in *US–Shrimp* that is largely devoiced from the policy objective of the general exceptions.[180] For the same reasons seen in the previous sections of this chapter, it seems reasonable to uphold that the certification requirements of Article 11 could constitute an unjustifiable discrimination.

The certification process of the third-country clause could also hide a potential 'arbitrary discrimination'. By way of example, this has been identified when there is a demonstrable lack of (i) transparency and predictability; (ii) a formal opportunity for an applicant

[175] *United States — Import Prohibition of Certain Shrimp and Shrimp Products – Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R [166-175].

[176] Ibid [172].

[177] Ibid [173-174].

[178] Ibid [175].

[179] *Brazil — Measures Affecting Imports of Retreaded Tyres – Report of the Panel* (3 December 2007) WT/DS332/AB/R [227].

[180] Julia Qin, 'Brazil–Tyres: Breaking New Ground in *Chapeau* Interpretation' (2007) <http://worldtradelaw.typepad.com/ielpblog/2007/06/braziltyres-bre.html> accessed 8 August 2017.

country to be heard; (iii) a procedure for the review of the refusal of an application.[181] As for this latter point, the Gas Directive does not set out any specific appeal procedure, but instead requires EU members to provide for an appeal mechanism.[182] This reflects the characteristics of the legislative instrument used – a directive, for which the EU sets the objectives and MSs implement it with the necessary national laws and regulations – and seems to be compatible with the *chapeau,* since EU MSs are bound to fully transpose EU law in their territory. Contrastingly, the certification process set out under the Gas Directive seems not to be as transparent and predictable in its outcome for the undertakings concerned, as required by point (i) above.

The alleged arbitrary discrimination is limited by the *chapeau* to cases where 'like conditions prevail'.[183] In *US – Shrimp,* the Appellate Body criticised the United States because the regulation under investigation did not consider the existing differences between the affected Members when it imposed an embargo on the products of third countries which did not comply with the US shrimp regulation.[184] In principle, the existing differences are not limited to exporting countries and may refer also to importing Members. Given that, in practice conditions will almost always differ from the theory; it appears that, in order to be consistent with the *chapeau*, a measure should be fairly

[181] To this end, the Appellate Body used arguments based on Art. X(3) GATT relating to the transparency and administration of regulations relating to goods. See Cottier, Delimatsis and Diebold (n 138). See also *US-Shrimp* (n 175) [179-181].

[182] Article 4 of the Gas Directive states that: 'Member States shall ensure that the reasons for any refusal to grant an authorisation are objective and non-discriminatory and that they are given to the applicant. Reasons for such refusals shall be notified to the Commission for information. Member States shall establish a procedure enabling the applicant to appeal against such refusals'.

[183] The *chapeau* of the GATT reads: 'Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, […]'. The *chapeau* of the GATS reads: 'Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, […]'.

[184] *US-Shrimp* (n 175) [161-165].

flexible to take into account the specific conditions prevailing in any WTO Member.[185] In this respect, the Gas Directive does not seem to meet this requirement. Indeed, it seems equivalent to the measure banned in *US – Shrimp*, which, in its application, imposed an economic embargo requiring all exporting Members, if they wished to exercise their GATT rights, to adopt essentially the same policy as that applied to United States domestic shrimp trawlers.[186] The same holds true for the Gas Directive, which bans foreign undertakings which are not unbundled from operating in the EU and does not adapt this requirement to the conditions present in the different States.

The third element of the *chapeau* – i.e. the measure should not constitute a disguised trade restriction – has not yet been the object of an extensive analysis by the Appellate Body. Looking at Article XX GATT case-law, the expression 'disguised trade restriction' encompasses both arbitrary and unjustifiable discrimination, but covers other measures as well.[187] To date, the meaning of the expression remains a bit elusive.[188] The Appellate body in *US-Shrimp* and *Brazil Retreated Tyres* focused on the discriminatory aspect of the measures under analysis rather than on developing a proper definition of the expression.[189] Given the uncertainties on the matter, for our purposes we don't need to

[185] Wolfrum, Stoll and Feinäugle (n 123) 324.

[186] *US-Shrimp* (n 175) [161, 164].

[187] Cottier, Delimatsis and Diebold (n 138). See also *United States — Standards for Reformulated and Conventional Gasoline – Report of the Appellate Body* (29 April 1996) WT/DS2/AB/R [25].

[188] William J Davey, *Non-discrimination in the World Trade Organization: The Rules and Exceptions* (AIL Pocket 2012) 328.

[189] *Brazil – Retreated Tyres* (n 179) [7.306], [7.347–349]; *US-Shrimp* (n 175) [35]. With the aim of obtaining a clear-cut definition on the matter, in 2009 China, Pakistan and Switzerland asked for a formal clarification of the expression 'disguised trade restriction' which remains unanswered. See Working Party on Domestic Regulation, 'Communication from China, Pakistan and Switzerland: Questions on 'Disguised Restrictions on Trade in Services' in relation to the GATS Negotiations on Domestic Regulation' [2009] JOB(09)/182.

concern ourselves with this complication considering this additional element should include both discrimination and arbitrariness, which have already been assessed above.

In light of the foregoing discussion, the Gas Directive does not seem to satisfy the requirements for the application of the *chapeau*. Therefore, the EU cannot invoke the application of the general exceptions to justify the breaches of the WTO rules described in the previous sections of this chapter.

## 7. Security Exceptions

Article XXI GATT and Article XIV-bis GATS set out the 'security exceptions' that are applicable in case of breach of other provisions of the two agreements. We will focus only on letter(b)(iii) to those articles, since that is the only clause which is relevant for our purposes. We will assess the two provisions simultaneously as their wordings are almost identical.[190] Pursuant to Article XXI GATT and Article XIV-bis GATS:

> Nothing in this Agreement shall be construed:
>
> (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests
>
> …
>
> (iii) taken in time of war or other emergency in international relations

WTO MSs have seldom invoked the security exception above, which allows WTO Members to take any measure they consider necessary to guarantee their security. The broad wording of the provision reflects the period in which it was written. Immediately

[190] While the GATT uses the word 'Contracting Party', the GATS uses the word 'Member'.

after WWII, the founders of the GATT did not want to be bound to trade with their former enemies, as they feared this could later cause problems for their internal security.

The security exceptions set forth under the GATT and the GATS allow States to restrict trade in order to protect strategic domestic production capabilities from import competition.[191] The definition of strategic good/service is left to the individual State concerned. However, there is little doubt that WTO Members would consider energy production as strategic. This is likely to occur as historically energy production has been closely intertwined to the principle of ownership over natural resources of the territory under the sovereignty of a State.[192]

The literal meaning of the expression 'any action which it considers necessary' is incredibly broad, and seems to impose no restrictions on WTO Members' discretion. Even though WTO case-law did not address the issue, it seems reasonable to say that there must be the possibility of a DSB's review over the reasonableness of the measures taken by WTO Members.[193]

As underlined by Nicaragua in *US-Nicaraguan Trade*, the application of the exception under letter b(iii) requires two conditions: (i) the measure under investigation shall be necessary for the protection of the security interest of the country invoking it; and (ii) it shall be taken in time of war or other emergency in international relations.[194] The application of both conditions to the case at issue seems to be questionable.

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[191] Van den Bossche and Zdouk (n 11) 595.

[192] For a complete overview of the matter see Marc Bungenberg and Stephan Hobe, *Permanent Sovereignty over Natural Resources* (Springer 2015) 4-15. The principle of ownership over natural resources is one of the cornerstones of international relationships, even if, after the decolonisation era, its application has been mitigated.

[193] *United States – Trade Measures Affecting Nicaragua* (13 October 1986) L/6053 [5.8-5.9].

[194] Ibid [4.5].

The first condition requires that the Gas Directive is necessary to protect a security interest of the Union. The security of natural gas supply is one of the reasons underlying the adoption of the Gas Directive. This is evident since the first recitals of the document, where security of supply is defined as 'an essential element of public security and is therefore inherently connected to the efficient functioning of the internal market in gas and the integration of the isolated gas markets of Member States'.[195] In this context, the gas transmission system is considered 'of high importance to the Community'.[196] For this reason, the EU legislator states that 'additional safeguards are necessary regarding the preservation of the security of supply of energy to the Community to avoid any threats to public order and public security in the Community and the welfare of the citizens'.[197]

The Gas Directive identifies three elements to evaluate the security of energy supply level achieved in the Union. These are (i) the assessment of the independence of network operation; (ii) the level of the Community's and individual Member States' dependence on energy supply from third countries; and (iii) the treatment of both domestic and foreign trade and investment in energy in a particular third country.[198] In relation to point (i) above, according to the EU legislator 'ownership unbundling … is clearly an effective and stable way to solve the inherent conflict of interests and to ensure security of supply'.[199] From the EU perspective, security of supply importance is demonstrated also by the fact that derogations from unbundling and third party access ('TPA') obligations

[195] Gas Directive, recital 22.

[196] Ibid.

[197] Ibid.

[198] Ibid.

[199] Gas Directive, recital 8.

are possible only for 'security of supply reasons'[200] and, in particular, are conceived for 'new pipelines within the Community transporting gas from third countries into the Community'.[201]

In sum, it is clear that for the EU the adoption of the Gas Directive is justified on the basis of security reasons. In this respect, States can determine the extent of their security interests. However, protective measures should be reasonable – in application of the principle of good faith – and necessary to achieve the security objective set.[202] In case of the Gas Directive, the ownership unbundling model for new pipelines does not seem to be the most suitable way to guarantee the security interests of the EU for four reasons. First, apart from the empirical evidence criticising the application of the ownership unbundling model,[203] TPA obligations enforced upon the manager of the grids, coupled with an invasive NRA supervision, seem to be sufficient alone to achieve the expected security results.[204] Second, the post-2007 international energy scene is characterised by a

[200] Gas Directive, recital 35. See also Gas Directive, Article 36.

[201] Ibid.

[202] Danae Azaria, *Treaties on Transit of Energy Via Pipelines and Countermeasures* (OUP 2015) 87. See also Beatriz Huarte Melgar, *The Transit of Goods in Public International Law* (Brill Nijhoff 2015) 114. Good faith is a general principle of international law, recognised as applying to the trade law matters in *US — Shrimp* (n 175) [158]. See Marion Panizzon, *Good Faith in the Jurisprudence of the WTO: The Protection of Legitimate Expectations, Good Faith Interpretation and Fair Dispute Settlement* (Hart Publishing 2006) 51.

[203] Christian Growitsch and Marcus Stronzik, 'Ownership Unbundling of Gas Transmission Networks – Empirical Evidence' (2009) EWI Working Paper 07/11, 15 <http://www.ewi.uni-koeln.de/fileadmin/user_upload/Publikationen/Working_Paper/EWI_WP_11-07unbundling_gas.pdf> accessed 13 May 2015.

[204] Vidmantas Jankauskas, 'Implementation of Different Unbundling Options in Electricity and Gas Sectors of the CEE EU Member States' (2014) 60(1) Energetika 47, where we read 'Analysis of the liberalisation options implemented in Latin America has shown that full ownership unbundling comes along with high costs in restructuring periods, whereas the third party access (with softer requirements for unbundling) would avoid the costs of unbundling but is expected to have a similar potential of cost reduction [for final customers] if tight supervision is exerted by a regulatory authority'. See also Dominik Schober, 'Static v Dynamic Impacts of Unbundling: Electricity Markets in South America' (2013) Discussion Paper No. 13-033, ZEW – Zentrum für Europäische Wirtschaftsforschung / Center for European Economic Research.

natural gas oversupply due to the massive production of shale gas and the increased possibility of importing LNG from long-distance producers.[205] This enhances supply diversification and, consequently, the security of supply of the importing countries. This is evident in case of the EU, which experienced also a huge contraction in gas consumption in the last decade compared to mid-2000s forecasts, due to the 2007 recession and the huge investments in renewable energies.[206] Third, gas spot markets have decoupled importers from long-term agreements which historically bounded them to producers with take-or-pay clauses.[207] This development enables supplied countries to face sudden gas shortages by purchasing the extra gas required on a daily basis.[208] With specific focus on Russia, Gazprom accepted to renegotiate long-term agreements with EU suppliers signed years before.[209] In this respect, as mentioned in chapter I, Europe is the first market for Gazprom and the company is highly dependent from European consumption. It is a vital interest both for Gazprom and for Russia to keep the EU supplied with gas (given the impact of the company on Russia's GDP). Therefore, it is not reasonable to consider Gazprom as a danger for the European security of supply. Fourth, Member States have progressively increased their strategic natural gas stocks as a backup tool in case of unexpected shortages.[210]

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[205] See Chapter II, section 4.

[206] Eurostat, 'Natural Gas Consumption Statistic' (2017) <http://ec.europa.eu/eurostat/statistics-explained/index.php/Natural_gas_consumption_statistics> last accessed 17 June 2017; Deloitte, 'Vision 2040: Global Scenarios of the Oil and Gas Industry' (2007) <https://www.deloitte.com/content/dam/Deloitte/ru/Documents/energy-resources/ru_er_vision2040_eng. pdf> accessed 16 June 2017.

[207] See chapter II, section 4.

[208] Pierre Vergerio, 'Long-Term Gas Contracts: Time for a New Deal' (2016) <https://www.naturalgasworld.com/long-term-gas-contracts-time-for-a-new-deal-27751> accessed 18 June 2016.

[209] See Danila Bochkarev, 'Gazprom Plays Ball: The Depoliticization of the European Gas Market' (2017) <http://energypost.eu/depoliticization-european-gas-market/> accessed 28 August 2017.

[210] Robert Zajdler, *EU Energy Law: Constraints with the Implementation of the Third Liberalisation Package* (Cambridge Scholars Publishing 2012) 55.

Hence, ownership unbundling – the only unbundling model which can be chosen for new infrastructure projects – does not seem to be 'necessary' to protect EU security interest both when considering the time of the adoption of the Gas Directive and when looking at today's situation.

Moreover, with reference to Article 11, the EU does not explain why security needs would require foreign undertakings to be treated less favourably than domestic ones. The recitals of the Gas Directive, outlining the reasons underlying its adoption, take into account third countries dependency only to evaluate the security of supply of the EU and of its members.[211] With the same purpose, 'foreign trade and investment in energy in a particular third country' are taken into account.[212] Both these considerations do not seem to justify a different approach in the certification process towards third countries undertakings in comparison to domestic companies. By upholding a security reason behind Article 11, the EU would implicitly mean that it felt an actual need to secure its gas supply against all third countries, irrespective of the specific situation of these latter. This does not seem to be a reasonable justification to breach WTO rules.

When carefully analysed, things have changed since the mid-2000s, when the first preparatory works of the Gas Directive were drafted. The rise of the security of supply issue was strictly linked to the eastward enlargement of the European Union – when the new EU countries were highly or even fully dependent on Russian gas – and natural gas consumption forecasts showed a steady growth in the subsequent years.[213] Today's situation is markedly different, and not only from an economic perspective. Even in

[211] Gas Directive, recital 22.

[212] Ibid.

[213] Deloitte (n 206).

Eastern European countries, supply diversification helped to lower the need for Russian gas. The fact that single EU Member States still import a substantial amount of the commodity from Russia does not necessarily mean that they are vulnerable to supply disruptions, arbitrary pricing and so on.[214] For example, despite being highly reliant on Russian gas, the construction of interconnectors allowed Czech Republic to be connected to the German market and to be supplied with German gas. The fact that Germany, in turn, is supplied by Russia does not impact on the possibility for Czech Republic to access Norwegian and Dutch gas, as well as LNG through the interconnectors built.[215] Poland is another example which corroborates the same reasoning.[216] Besides, a reciprocal assistance in case of supply disruptions derives from Article 122 TFEU, whereby, in case of natural gas shortages, Member States shall act in a spirit of solidarity.[217]

In sum, in case of WTO litigation, the DSB could find that the measures adopted under the Gas Directive are not necessary to achieve the security of supply of the EU and, therefore, that they do not satisfy the first requirement of letter b(iii) to Articles XXI GATT and XIV-bis GATS.

Even assuming the contrary, the other element required under letter b(iii) is that the measure under investigation is taken in time of war or during an emergency in international relations. This does not seem to be the case with the Gas Directive. Even if the gas shortages due to the 2006 Russian-Ukrainian crisis triggered the 2007 Energy Sector Inquiry and, consequently, the Gas Directive in 2009, letter b) to Articles XXI

[214] Tim Boersma, 'The Challenge of Completing the EU Internal Market for Natural Gas' (2015) Swedish Institute for European Policy Studies 27 <http://www.sieps.se/sites/default/files/2015_27_epa_%20eng.pdf> accessed 16 June 2017.

[215] Ibid.

[216] Ibid 3.

[217] See section 2.1 of Chapter IV.

GATT and XIV-bis GATS needs that the measure under investigation is taken in and because of the emergency occurred. The Gas Directive was adopted three years after the first Ukrainian crisis. This is enough *per se* to exclude the existence of the link required by letter b). In addition to that, the EU was not party to the 2006 gas dispute, even if, because of that, it experienced some gas shortages.

## 8. Interim Conclusion

In this chapter, we analysed the Gas Directive *vis-à-vis* the anti-discrimination and the market access obligations laid down under the GATT and the GATS.

We found out that the Gas Directive is likely to cause problems under all the WTO provisions analysed. This answers to the second question we outlined in the introduction of this work.[218] In particular, both *de jure* and *de facto* the Gas Directive could negatively impact on the possibility for extra-EU companies to operate and import their natural gas in the Union. In case of a WTO decision on the topic, still pending at the time of writing,[219] the EU could not take advantage of the application of the general or of the security exceptions provided for under both WTO agreements. This is likely to cause the panel to condemn the EU for breaching the WTO rules and to request the EU to alter the provisions of the Gas Directive.

The consequences of such a ruling would be likely to give Russia a powerful tool to regulate its energy relationship with the EU. As we have seen, WTO rules are the only international instrument capable of redefining from a legal perspective the EU-Russia relationship, and, for this reason, they could have a dramatic impact on the

[218] See introduction, section 8.

[219] Case updates can be retrieved from *European Union and its Member States — Certain Measures Relating to the Energy Sector* WT/DS476 <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds476_e.htm> accessed 15 April 2018.

interdependence between the two parties. Moreover, by forcing a change of the Gas Directive, Gazprom would be likely to have a bigger market power in the EU midstream and downstream sectors, reinforcing its dominant position in the EU gas supply.

The EU approach to energy significantly changed with the adoption of the Lisbon Treaty. This did not impact on the Gas Directive and on the internal natural gas market as such. However, the exploitation of the tools made available under the Lisbon Treaty could deeply modify the EU-Russia future energy relationship. For this reason, in Chapter I we defined the Lisbon Treaty as a turning point of the European energy action.

In the next chapter, we will analyse the novelties brought by the Lisbon Treaty in the EU energy sector and their impact on the EU-Russia energy relationship. In particular, we will try to find out whether the new legislative measures adopted could help to solve some of the inconsistencies, illustrated so far in this work, between the EU and its suppliers.

# IV

## THE EMERGENCE OF A NEW APPROACH AFTER LISBON

**Summary**: 1. Introduction – 2. The Novelties of the Lisbon Treaty with Impact on the Energy Field – 3. The European Energy Union – 4. Post Energy Union Regulatory Measures – 5. The Characteristics of the New EU Approach – 6. Interim Conclusion.

### 1. Introduction

In the introduction, we outlined that this thesis explores the international and national legal tools binding the EU and Russia in the energy field and how they impact on the EU-Russia geopolitical relationship.

In Chapter I, we explained that the EU approach was characterised internally by a pervasive regulation of the market aimed at enhancing competition and externally by bilateralism as a default approach of engagement with third countries, which ultimately favoured the adoption by Russia of a divide-and-rule policy towards single EU Members.

In the following chapters, we have underlined that the provisions of Directive 2009/73/EC ('the Gas Directive'), the most important piece of legislation governing the EU gas market, could be illegal and potentially contrast with international trade rules binding the EU. Moreover, we have seen the Gas Directive does not seem to provide enough investment incentives to the undertakings operating – or willing to operate – in the European natural gas market.

This chapter outlines an emerging 'new' approach of the EU in the gas sector, which started to take shape with the adoption of the Lisbon Treaty in 2009, after the issuance of the Gas Directive, and that is still 'under construction'. This approach significantly differs from the previous one; it is characterised by the progressive centralisation of the energy competences at the European level, a primary role of the EU institutions in dealing with

energy issues of European relevance, the focus on the security of supply of the Union and a push for technological innovation.

The new approach could help solving some of the issues underlined in Chapter I and Chapter III. In particular, by promoting a united European stance towards third country suppliers, the post-Lisbon approach could overcome the lack of coherence which characterised the EU energy policy towards Russia before. Overall, the legislation adopted post-Lisbon will enhance the EU security of supply through the possibility to conclude specific bilateral energy agreements and the scrutiny of the commercial agreements between undertakings, and empowers the EU with new legal tools to rebalance its energy relationships with Russia. All of this verifies the hypothesis made in the conceptual framework, i.e. that the introduction of a specific section related to energy in the TFEU effectively impacts on the energy relationship between the EU and its suppliers.

In the next sections, we will outline the characteristics of the post-Lisbon energy approach, starting from the new competence allocation between the EU and its Member States regarding energy and foreign direct investments.

## 2. The Novelties of the Lisbon Treaty with Impact on the Energy Field

### 2.1 Energy and Solidarity

The Treaty of Lisbon first introduced the energy field in a specific section of the Treaty (Title XXI),[1] and listed it among the competences shared between Member States and the

[1] The Treaty of Lisbon entered into force on 1 December 2009 as the latest landmark in the Union's evolved constitutional architecture. It amended the existing EU treaties and renamed them into the current Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU).

Union.[2] Before Lisbon, the EU could intervene in the energy sector only indirectly, by means of Article 175 TEC (on environmental protection), Article 95 (approximation of laws, such as in the case of the Gas Directive), Articles 155 and 156 (trans-European networks), and Article 100 (difficulties in supply).[3] These articles typically required burdensome procedures (qualified majorities or, in some cases under Article 175, unanimity), whereas, under the Lisbon Treaty, energy follows the faster ordinary legislative procedure.[4]

Article 194(1) TFEU states that,

> In the context of the establishment and functioning of the internal market […] Union policy on energy shall aim, in a spirit of solidarity between Member States, to:
>
> (a) ensure the functioning of the energy market; (b) ensure security of energy supply in the Union; (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and (d) promote the interconnection of energy networks.

The TFEU outlines that Article 194(1) refers to internal measures only.[5] Any form of external action by the EU will have to be implied from its internal rules, in compliance with the *ERTA* jurisprudence.[6] In a landmark preliminary reference case about green

[2] TFEU, Article 4(2).

[3] Jean-Claude Piris, *The Lisbon Treaty: A Legal and Political Analysis* (CUP 2010) 318.

[4] TFEU, Article 194(2).

[5] Heiko Krüger, *European Energy Law and Policy: An Introduction* (EE 2016) 149.

[6] Case C-22/70 *Commission v Council* [1971] ECR 263. See Rafael Leal-Arcas and Juan Alemany Rios, 'The Creation of a European Energy Union' (2015) 5 European Energy Journal 29.

energy, the Court of Justice of the European Union confirmed the Union's external competence in the field of energy based on *ERTA* case-law.[7]

Significantly, Article 194 stipulates that the aims of the Union's energy policy shall be pursued 'in a spirit of solidarity' between Member States. In this respect, as chapter I explains,[8] the signing of bilateral deals with suppliers such as Gazprom, were repeatedly seen as undermining the development of a coherent external energy policy.[9] Several Eastern European Member States have been keen on the Commission playing a more active role when it comes to energy which other Member States have been quick to shut down on the grounds that the EU lacked competence and that foreign policy was a Member State responsibility.[10]

In addition to the 'solidarity spirit' of Article 194, one feature of the Lisbon Treaty that warrants attention with specific reference to energy is the solidarity mechanism of Article 122(1) TFEU:

> without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy.

[7] Case C-66/13 *Green Network SpA v Autorità per l'Energia Elettrica e il Gas* [2014] ECLI:EU:C:2014:156.

[8] See chapter I, section 7.

[9] Katinka Barysch, 'Should the Nabucco Pipeline Project be Shelved?' (2010) Centre for European Reform 4 <http://www.cer.eu/sites/default/files/publications/attachments/pdf/2011/pb_nabucco_5may10-221.pdf> accessed 17 March 2017.

[10] Ibid 5.

The Council made repeated references to solidarity during the 2009 gas crisis and therefore this mechanism can be seen as a test of Member State dedication to the Lisbon Treaty's solidarity provision based on the level of implementation thereof.[11] However, given the fact that solidarity is not a quantitative concept, it is therefore subject to Member States' interpretation and support in times of crisis.[12] Nevertheless, the specific mention of energy in relation to supply included under Article 122 creates a legal basis whereby the Union can intervene to the extent that there are any supply disruptions.[13] In this respect, the solidarity principle sets a legal base for the measures to be taken in a time of crisis to ensure security of supply.[14]

### 2.2 Foreign Direct Investment

With the adoption of the Lisbon Treaty, foreign direct investment ('FDI') has become an exclusive EU competence, integrated into the Common Commercial Policy ('CCP'). This results from the combined reading of Article 3(1)(e) (setting out the exclusive EU competence for CCP), and Article 207 TFEU (on FDIs), and could have an impact on the EU-Russia energy relationship.

The expression 'foreign direct investment' is not defined in the Treaty.[15] Notwithstanding, the relationship between Article 207 on one side and the bilateral

[11] Sijbren De Jong, Jan Wouters and Steven Sterk, 'The 2009 Russian-Ukrainian Gas Dispute: Lessons for European Energy Crisis Management after Lisbon' (2010) 15(4) European Foreign Affairs Review 525.

[12] Sijbren De Jong and Jan Wouters, 'European Energy Security Governance: Key-Challenges and Opportunities in EU-Russia Energy Relations' (2011) Leuven Centre for Global Governance Studies 41.

[13] Ibid.

[14] Ibid.

[15] Kevin Kazimirek, 'The New EU Competence over Foreign Direct Investment and its Impact on the EU´s Role as a Global Player' Jean Monnet Centre for Europeanisation and Transnational Regulations Oldenburg (2012) 23 <http://www.cetro.uni-oldenburg.de/download/CETRO_Selected_Theses-_Kazimirek.pdf> accessed 12 June 2016.

investment treaties ('BITs') signed by the Member States ('MSs') with third countries on the other side immediately became a contentious issue. What was missing in the Lisbon Treaty, and also became an issue in practice, were any transitional provisions clarifying the status of existing extra-EU BITs.[16] It was only in 2012 that Regulation 1219/2012 confirmed that extra-EU BITs remain binding on the MSs under public international law, putting an end to controversies regarding the legal effect of BITs between EU Member States and non-EU countries.[17] Accordingly, international agreements concluded before the State accession to the EU find application even in case of clash with EU law.[18] However, as the regulation explains, these treaties will be progressively replaced by investment agreements signed by the EU and third states on the basis of the new EU competence.[19] When such agreements are signed, Member States will be required to withdraw their authorisation of the respective existing BITs.

To date, about half of the BITs world-wide have at least one EU Member State as a party.[20] These include also intra-EU BITs, which the EU is trying to root out because of the possible conflicts with the internal market rules. With its exclusive competence on foreign direct investments, the EU will progressively take a primary role in the treaty making processes of global investment law. This trend is evidenced by the negotiations of the Comprehensive Economic and Trade Agreement (CETA) and the Transatlantic

[16] European Parliament and Council Regulation 1219/2012 of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries' [2012] OJ L351, Recital 4. At the time of the entry into force of the Treaty of Lisbon, Member States maintained a significant number of bilateral investment agreements with third countries. The TFEU does not contain any explicit transitional provisions for such agreements which have now come under the Union's exclusive competence. This led to interpretative *lacunae* regarding the new EU competence on FDIs.

[17] See chapter I, 22.

[18] Ibid.

[19] Regulation (EU) No 1219/2012, Arts 5-6.

[20] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (2nd edn, OUP 2012) 11.

Trade and Investment Partnership (TTIP), two of the most important multilateral investment treaties of the last years, which the European Commission ('EC') negotiated in the name of the whole Union.

In the context of the negotiations of investment chapter of the EU-Singapore free trade agreement (EUSFTA), aiming at superseding the existing BITs between Singapore and EU MSs, the EC requested a preliminary opinion to the Court of Justice of the European Union ('CJEU') on the extent and nature of the EU CCP competence to conclude the trade agreement, 'since differences of opinion became apparent in consultations within Trade Policy Committee'.[21] In May 2017, the CJEU issued its opinion, which clarifies the impact of the new competence on the power allocation between the EU and its Members.

According to the CJEU, in relation to the EUSFTA the EU has the exclusive competence to regulate goods and services market access, public procurement, non-fossil fuel energy generation, foreign direct investment protections, IP rights, competition rules, sustainable development, exchanging information in areas requiring mediation, cooperation and disputes.[22] Under the EUSFTA, two areas would specifically need the approval from national parliaments before they can be applied, namely non-direct foreign investments (e.g. portfolio investments) and the regime governing dispute settlement between investors and States (ISDS provisions).[23]

[21] Court of Justice of the European Union, 'OPINION 2/15 OF THE COURT (Full Court)' (16 May 2017) ECLI:EU:C:2017:376 <http://curia.europa.eu/juris/document/document_print.jsf?doclang=EN&text=&pageIndex=0&part =1& mode=req&docid=190727&occ=first&dir=&cid=441679> accessed 20 May 2017.

[22] Ibid, 238, 304.

[23] Ibid.

The opinion of the CJEU shed light on the question of 'mixity', which created conflicts between the EU and MSs also with regards to TTIP and CETA, with national governments claiming a primary role in the negotiation process after several protests spread around Europe for a more conservative approach to trade liberalisation in defence of national goods and services.

In sum, the CJEU made clear that the scope of the CCP competences transferred to the Union by the Lisbon Treaty, albeit strengthened,[24] is not sufficiently broad to cover all the aspects which are usually included under a BIT.[25] Therefore, the adoption of an all-encompassing investment agreement necessarily requires the intervention of national parliaments. One way around this, which could help avoid delays and complications, would be for the EU to reconsider the content of its trade agreements and avoid the inclusion of non-direct investment or ISDS provisions, to facilitate their conclusion by the EU alone. This would be a major change of EU current policy and it is not clear whether it would be contemplated. Another viable option for the EU might be to adopt ISDS as a standalone protocol, subject to separate conclusion and approval, but this could leave investors without any protection in the interim.[26]

In addition to the new position on FDI, which could allow the conclusion of an EU-Russia agreement substituting the BITs signed by individual MSs, a more assertive EU approach appears to be emerging within the energy sphere with the Commission undertaking a

[24] With the Lisbon Treaty, the Common Commercial Policy now covers trade in services, the commercial aspects of intellectual property as well as foreign direct investments. This greatly expands the EU's exclusive competence in the field. See Paul Craig and Gráinne de Búrca, *EU Law: Text, Cases and Materials* (5th edn, CUP 2011) 322.

[25] Kazimirek (n 15).

[26] Herbert Smith Freehills LLP, 'The European Court of Justice Renders its Opinion on the EU-Singapore Free Trade Agreement: Investment Chapter Is Not within EU's Exclusive Competence' (2017) <http://www.lexology.com/library/detail.aspx?g=e2568c28-1a23-47fa-874d-8959bd2f8b97> accessed 10 June 2016.

mandate to bolster European energy security. The impetus for this assertive stance was triggered by the progressive shift of competences from Member States to the EU. The progressive centralisation of energy decision-making could have an impact on the geopolitical relations of the EU with third countries, by increasing the efficiency of the internal market as a single block and reinforcing the overall bargaining power of EU Members. The last step towards the centralisation of energy competences at the European level was the publication of the Energy Union plan.

## 3. The European Energy Union

### 3.1 Introduction

The long awaited Sustainable Energy Security Package which was announced on 12 February 2016, is the latest step undertaken by the EU towards the creation of the European Energy Union.[27] Even though the idea of a new common energy policy has been advocated for since 2010 by former European Commission President Jacques Delors and the then European Parliament Polish President Jerzy Buzek,[28] the idea of a proper Energy Union first materialised in spring 2014, after the concerns about a potential politically motivated disruption of all EU gas supplies from Russia due to the Crimea crisis.[29]

[27] European Commission, 'Press Release: Towards Energy Union: The Commission Presents Sustainable Energy Security Package' (2016) <http://europa.eu/rapid/press-release_IP-16-307_en.htm> accessed 20 August 2016.

[28] Sami Andoura, Leigh Hancher and Marc Van Der Woude, 'Towards a European Energy Community' (2009) <http://www.notre-europe.eu/media/etud76-energy-en.pdf?pdf=ok> accessed 20 August 2016.

[29] The 2014 natural gas interruptions have been the third part of the 'gas wars' involving Russia and Ukraine. The first two gas wars took place in 2006 and 2009. See chapter I, section 2.

The current president of the European Commission Jean-Claude Juncker made the Energy Union a top priority of his mandate during his 2014 presidential campaign.[30] The reason behind this is simple and had been mentioned already in chapter I: Many EU Member States rely heavily on a limited number of energy suppliers.[31] Some of them, especially in the Eastern part of Europe, have one supplier only, which leaves those countries very vulnerable in the event of any unexpected energy supply disruptions.[32]

Improving energy interconnections between new Member States, especially in those countries which once were part of the former Soviet Union, and modernising their infrastructure would help to minimise disruptions and energy dependency. In addition, the completion of the internal energy market would allow easier access to energy markets across national borders and improve the affordability of energy and the competitiveness of energy prices for citizens and businesses.

In November 2014, Maroš Šefčovič, the EU Vice-President in charge of the Energy Union project, announced the five key pillars of the Energy Union strategy, which were then fleshed out on 25 February 2015, when Commissioner Šefčovič officially presented the Energy Union package.[33] These are:

1) stronger emphasis on security of supply, solidarity and trust;

[30] Jean-Claude Juncker, 'A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change' (2014) <http://ec.europa.eu/priorities/sites/beta-political/files/juncker-political-guidelines_en.pdf> accessed 26 August 2016.

[31] See Chapter I, section 3.

[32] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of Regions, and the European Investment Bank: A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy' COM (2015) 080 final, 2.

[33] European Commission, 'Energy Union: Secure, Sustainable, Competitive, Affordable Energy for Every European' (2015) <http://europa.eu/rapid/press-release_IP-15-4497_en.htm> accessed 12 August 2016.

2) the finalisation of the internal energy market;

3) the moderation of demand for security through energy efficiency;

4) the decarbonisation of the energy mix;

5) improved efforts in research, innovation and competitiveness.[34]

The five pillars above fully reflect the content of Article 194(1) TFEU and sum up the most important steps of the European energy policy for years to come.[35]

### 3.2 Outline of the Energy Union's Pillars

The first point of the Energy Union strategy stresses the importance of the security of energy supply. With this in mind, the Commission strives for the consolidation of joint approaches aimed at strengthening solidarity between Member States, in particular in times of crisis, so that members could be assured that in situations of tight supply they can rely on their neighbours.[36] The list of the actors involved in this cooperative project extends to Member States, transmission system operators, the energy industry and all other stakeholders, which will have to work closely together to ensure a high-level of energy security for European citizens and companies.[37] A closer integration of the EU,

[34] Maroš Šefčovič, 'Opening Speech - EU Energy Policy and Competitiveness' (2014) <http://europa.eu/rapid/press-release_SPEECH-14-1883_en.htm> accessed 28 August 2016. The five pillars of the Energy Union are based on the three long-established objectives of EU energy policy: security of supply, sustainability and competitiveness.

[35] Urbán Rusnak, Secretary General of the Energy Charter Treaty, highlighted the relevance of the Energy Charter Treaty to each of the five dimensions of the Energy Union. Rusnak emphasised that 'the foundation for the external policy of an Energy Union has already been laid by the establishment of the Energy Charter Treaty'. See Energy Charter Secretariat, 'The Energy Union Conference 'The Five Dimensions of the European Energy Union Session'' (2015) <https://eu2015.lv/images/notikumi/2015_02_06_SGs_address_in_Riga.pdf> accessed 18 June 2017.

[36] To ensure the diversification of the gas supply, work on the Southern Gas Corridor must be intensified to enable Central Asian countries to export their gas to Europe. In Northern Europe, the recent establishment of liquid gas hubs with multiple suppliers is greatly enhancing supply differentiation. See European Commission, 'Quarterly Report on European Gas Markets' (2014) <https://ec.europa.eu/energy/sites/ener/files/documents/quarterly-gas_q3_2014_final_0.pdf> accessed 18 June 2017.

[37] European Commission (n 32) 7.

the Energy Community and their third partners is also relevant,[38] so that the European reforms and incentives are extended to neighbour energy transit countries. This action is complementary to the diversification of supply, which is to be pursued through the funding and construction of Projects of Common Interest.[39]

In relation to third supplying countries, such as Russia, the EU plan is to speak with one voice, improving its ability to project its weight on a global scale. From this perspective, EU trade policy is key in contributing towards greater security and diversification through the inclusion of energy-related provisions in trade agreements with its partners. When the EU negotiates agreements with countries that are important for its security of supply, the Commission shall seek to negotiate energy specific provisions contributing to the energy security and sustainable energy goals of the Energy Union.

As an additional tool, the European plan mentions the possibility of setting up voluntary demand aggregation mechanisms to collectively purchase gas during a crisis and also where Member States are dependent on a single supplier. This reshaped the single buyer

[38] The Energy Community Treaty is an international agreement signed in Athens on 25 October 2005, through which State parties, all non-EU countries, committed themselves to liberalise their energy markets according to the EU *aquis*. To date, the members of the Energy Community are the following: Albania, Bosnia and Herzegovina, Montenegro, Ukraine, Kosovo, Moldova, Serbia, Macedonia (as parties); Georgia, Armenia, Norway, Turkey (as observers).

[39] Projects of Common Interest ('PCIs') are identified by the European Commission as essential for completing the European internal energy market and for reaching the EU's energy policy objectives. To become a PCI, a project must have a significant impact on the energy markets and market integration of at least two EU countries, boost competition and the EU's energy security by diversifying sources, contribute to the EU's climate and energy goals by integrating renewables. PCIs may benefit from accelerated planning and permit granting, improved regulatory conditions, lower administrative costs due to streamlined environmental assessment processes, increased public participation via consultations, increased visibility to investors and access to financial support. To date, support under the Connecting Europe Facility (CEF) is provided in two forms – grants and financial instruments. PCI promoters are encouraged to use financial instruments before applying for grants. Grants and financial instruments are subject to different application procedures, different EU parties are involved, and different implementation plans apply. Grants should be seen as a funding resource of last resort. However, the limited amount of EU support (the CEF has €5.3 billion for all energy projects from 2014-20) and the rather political choice of where to allocate funds have prevented outright success. See: Simone Tagliapietra and Georg Zachmann, 'Rethinking the Security of the European Union's Gas Supply' (2016) Bruegel Policy Contributions <http://bruegel.org/2016/01/rethinking-the-security-of-the-european-unions-gas-supply/> accessed 8 January 2018.

option, one of the ideas which came up at the first stages of the reform process to lower suppliers' bargaining power.[40] In any event, it is recognised that these demand aggregation mechanisms would need to comply with World Trade Organization ('WTO') law and EU competition rules, in particular with the Commission's guidelines on horizontal cooperation agreements.[41]

As for the second point – the finalisation of the internal energy market – Commissioner Šefčovič underlined that 'the current market design does not lead to sufficient investments, market concentration and weak competition remain an issue and the European energy landscape is still too fragmented'.[42]

The Commission's plan aims at achieving Member States' full implementation and enforcement of the Third Energy Package, in particular as regards to unbundling and to the independence of national regulators.[43] This goes together with the continuous antitrust enforcement, ensuring a free energy flow by addressing territorial restrictions in supply contracts as well as upstream/downstream and network foreclosure.

In addition to that, the push for a better integration of the transmission operators, starting from a regional level, and the development of both short and long-term markets through

[40] Donald Tusk, 'A United Europe Can End Russia's Energy Stranglehold' (2014) <http://www.ft.com/cms/s/0/91508464-c661-11e3-ba0e-00144feabdc0.html#axzz3XSpZt4OX> accessed 16 August 2016.

[41] European Commission Regulation (EU) No 1217/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements' [2010] OJ L285/46. The best-known example of demand aggregation mechanism proposed in the past is the Caspian Development Corporation. This was a reply to Turkmenistan's offer to sell the EU 30 bcm of gas per year. Turkmenistan wanted a single buyer (it sells 60 bcm to China every year), but no single buyer in the EU could take more than 5 bcm. So, aggregation was almost mandatory, even if it was heavily criticised by EU companies.

[42] European Commission (n 31) 9.

[43] Ibid.

the exploitation of the full potential of liquefied natural gas ('LNG') will influence gas price formation and its stabilisation to the benefit of final users.

All these activities will entail further powers vested in the European regulators, in particular the European Networks of Transmission System Operators for Electricity and Gas (ENTSOs) and the Agency for Cooperation of Energy Regulators (ACER),[44] the setup of regional operational centres to effectively plan and manage cross-border gas flows, the fine-tuning of the network codes already in place, the adoption of facilitated permit procedures.

The third point of the Energy Union strategy pinpoints the utmost importance of energy efficiency for the security of supply of the Union. In 2014, the European Council set an indicative target of at least 27% of energy efficiency improvement by 2030 in comparison to the business-as-usual scenario.[45] This objective will be reviewed by 2020, with the goal being a level of 30%.[46] The Energy Union strategy highlights that most of the work to achieve the efficiency objectives set has to be done at the national level. In this context, the role of the Commission is to create the appropriate framework for the application of national policies.

Huge efficiency gains are to be captured with regard to district heating and cooling, the largest single sources of energy demand in Europe.[47] Moreover, the Energy Union strategy urges a 'comprehensive road transport package' with measures aimed at

[44] To date, ACER benefits of limited decision-making rights. It can only take decisions at the request of the national regulators or if these latter fail to take a decision within a certain timeframe.

[45] European Council, 'European Council (23 and 24 October 2014) Conclusions on 2030 Climate and Energy Policy Framework' 5 <http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/145356.pdf> accessed 28 August 2016.

[46] Ibid 6.

[47] European Commission (n 32) 12.

improving the efficiency of vehicles, road use, alternative fuels and their infrastructure, and public procurement of clean vehicles.[48] Considerable fuel savings could also be realised by removing barriers to less greenhouse gas intensive modes of transport, such as rail, maritime transport and inland waterways, and by making these modes more attractive. All these initiatives will contribute to lower the European energy needs and therefore decrease energy imports from outside the EU.

As regards the decarbonisation of the European economy, the fourth pillar of the European plan, the Energy Union strategy recalls the content of the agreement on the 2030 climate and energy framework, which has set the EU commitment of at least 40% of domestic reduction in greenhouse gas emissions compared to 1990.[49] This makes an ambitious contribution to the international climate negotiations, which has been reinforced at a global scale by the signing of the Paris Agreement in late 2015.

The cornerstone of Europe's climate policy is a well-functioning EU Emissions Trading System, stimulating cost-efficient greenhouse gas emission reductions. This is coupled with the EU objective of becoming the world leader in renewables by developing the next generation of technically advanced and competitive green energies. With this aim, existing legislation and new market rules need to be fully implemented, enabling the roll-out of new technologies and allowing for an efficient energy transition. This process will necessarily be guided by the Commission, which will promote cooperation and convergence of national support schemes leading to more cross-border opening.

Lastly, the Energy Union strategy puts research and innovation at the very heart of the EU project. In this respect, the European plan sets out four key priorities: (i) develop the

[48] Ibid 14.

[49] European Council (n 45) 2.

next generation of renewable energy technologies, including environment-friendly production and use of biomass and biofuels, together with energy storage; (ii) facilitate the participation of consumers in the energy transition through smart grids, smart home appliances, smart cities, and home automation systems; (iii) provide efficient energy systems, and harnessing technology to make the building stock energy neutral; and (iv) incentivise sustainable transport systems that develop and deploy at large scale innovative technologies and services to increase energy efficiency and reduce greenhouse gas emissions.[50] In this context, public procurement is seen as a potential catalyst for industrial and business innovation and green growth, both within the EU and beyond its borders, supporting other countries in their efforts to establish modern and sustainable energy systems.[51]

### 3.3 Security of Supply: The First Pillar of the Energy Union

Considering the content of the previous sections, it is worth outlining some general considerations about the relationship between security of the energy supply and the other four pillars of the Energy Union package. Indeed, with the Eastern enlargement of the EU and the gas wars with Russia, security of supply came under the spotlight and became the main objective of the EU energy policy. This trend is now reflected in the Energy Union strategy.

In principle, the progressive improvement of the internal gas market contributes to lowering the barriers to trade and to allowing a more efficient resource allocation between EU Member States. Overall, this decreases the amount of energy imported from third countries. The same holds true for energy efficiency. Indeed, the adoption of techniques

[50] European Commission (n 32) 16.

[51] Ibid 17.

improving the efficiency of the energy processes increases the amount of energy saved and, consequently, lowers energy importation. By the same token, green energy production is of utmost importance to secure the energy supply and to enhance the diversification of the energy mix. Energy from renewable sources is produced locally, by the natural sources of the territory. Hence, in a system dependent from third countries, renewable energies help to lower energy importation. Lastly, research activities and innovation help the development of new and more efficient energy production systems which accelerate the energy saving process described above. Remarkably, energy efficiency and green energy incentive policies are determined at the national level. States actively influence the national energy diversification by giving private parties the incentives to invest in the sector and help the diffusion of more efficient green energy productions.[52] This can have a spill-over effect in national job markets.

The strategic importance of the security of supply reflects one of the fundamental aims of nation States since their creation, which is now one of the key dimensions of the EU.[53] As the Council of the EU stated:

> completion of the internal energy market is a pre-requisite to achieve, in the most cost-effective way, the main objectives of the EU energy policy: sustainability, competitiveness and security of energy supply.[54]

[52] Limitations are imposed by European and international trade rules on subsidies.

[53] This concept has been outlined also in the first section of the introduction of this thesis.

[54] Council of the European Union, 'Completion of the Internal Energy Market' (2014) <www.consilium.europa.eu/en/workarea/downloadasset.aspx?id...> access 21 August 2016.

Over the last six decades, EU energy policy has been characterised by a continuing search for a balance among security of supply, environmental goals and market liberalisation goals, which constitute the three pillars of the EU energy policy.[55]

The good start of the Commission's plan was confirmed on 18 November 2015 in the first State of the Energy Union report.[56] Thereafter, on 16 February 2016 the Sustainable Energy Security Package proposed the amendment of two important pieces of legislation: Decision 994/2012/EU and Regulation 2012/994/EU. The proposals included a shift of competence from Member States to the EU as regards to the negotiation of intergovernmental agreements ('IGAs') in the field of energy between Member States and third suppliers and provided mechanisms to prevent security of supply disruptions. In addition to that, the Sustainable Energy Security Package set out a communication focused on LNG and gas storage, and proposed, for the first time, a heating and cooling strategy focused on removing barriers to decarbonisation in buildings and industry.[57] Notwithstanding the possible impact of the last two proposals on EU-Russia energy relations – in principle, LNG increases supply diversification, whereas the implementation of environmental-friendly policies decreases the dependency from imported 'grey' sources – the analysis of the first two measures is particularly relevant

[55] Bart Van Vooren, 'Europe Unplugged Progress, Potential and Limitations of EU External Energy Policy Three Years Post-Lisbon' (2012) 5 Swedish Institute for European Policy Studies, 13 <http://www.sieps.se/sites/default/files/2012_5.pdf> last accessed 11 June 2017.

[56] European Commission, 'First Report on the State of the Energy Union' (2015) <https://ec.europa.eu/commission/energy-union-and-climate/state-energy-union_en> accessed 11 June 2017. The report listed the first outputs of the Energy Union plan. These are, by way of example, the completion of an underground power line between France and Spain that doubles their interconnection capacity, proposals to revise the energy label for white goods and the launch of a new Strategic Energy Technology Plan.

[57] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: On an EU Strategy for Liquefied Natural Gas and Gas Storage' COM (2016) 49 final, and European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: An EU Strategy on Heating and Cooling' COM (2016) 51 final.

for the purposes of this thesis since they directly target third countries' energy policies and extra-EU companies operating in the Union. This shapes the international energy relationships of the Union with its suppliers.

In light of the above, the next section of this chapter analyses the proposals to amend Decision 994/2012/EU and Regulation 2012/994/EU.

## 4. Post Energy Union Regulatory Measures

### 4.1 Treaty Negotiation with Third Countries: A Change in Perspective

In 2012, the European institutions issued Decision 994/2012/EU (the 'IGA Decision'), establishing an information exchange mechanism with regard to IGAs signed between Member States and third countries in the field of energy.[58] This was the first attempt made by the EU to control the content of the energy agreements concluded by its members with countries which are not bound by EU law. IGAs are, usually, bilateral agreements that form the basis of private commercial contracts and investments.[59] Their purpose is to provide legal certainty for the construction of import and export infrastructure, to facilitate the purchase of oil and gas, or to establish a more general framework for energy cooperation.[60] Since EU energy market rules may not always be in the commercial interests of non-EU energy suppliers, single Member States may be pushed by their

[58] European Parliament and Council Decision 994/2012/EU establishing an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy [2012] OJ L299/13.

[59] Pursuant to Article 2 of the IGA Decision, an 'intergovernmental agreement' means 'any legally binding agreement between one or more Member States and one or more third countries having an impact on the operation or the functioning of the internal energy market or on the security of energy supply in the Union; however, where such a legally binding agreement also covers other issues, only those provisions that relate to energy, including general provisions applicable to those energy-related provisions, shall constitute an 'intergovernmental agreement''.

[60] Sonja van Renssen, 'EU Takes on Gas in First Battle for European Energy Union' (2016) <http://www.energypost.eu/eu-takes-gas-first-battle-european-energy-union/> accessed 21 August 2016.

supplying countries to include in their IGAs clauses that hinder the functioning of the EU internal energy market. To overcome this problem, the EU's approach towards these agreements has radically changed since the Lisbon Treaty was adopted.

The IGA Decision requires Member States to notify the Commission of all their energy agreements with non-EU countries once they have been concluded. In case of agreements under negotiation, Member States may inform the Commission about the content to be negotiated but they are under no obligation to do so.[61] Information included under the agreements may be shared with other Member States, except for any confidential part specifically indicated by the sender.[62] The Commission verifies whether the agreements signed comply with EU law, in particular with the rules on internal market and competition. In case of breach, it invites Member States to amend or terminate the IGAs in question. According to public international law, a State cannot unilaterally amend or revoke its IGAs obligations early without the consent of the other party.[63] Hence, the (political) renegotiation is required in the case of agreements falling foul of EU law.

The Commission's analysis of all notified IGAs showed that around one-third of them contained provisions that were not compliant with EU law.[64] To date, no such agreement has been successfully renegotiated.[65] The adoption of the IGA Decision deeply affected

[61] Article 3, IGA Decision. The impact assessment on the revision of the IGA Decision reveals that no draft IGA has ever been submitted to the Commission on a voluntary basis for an *ex-ante* check. See European Commission, 'Impact Assessment: On Establishing an Information Exchange Mechanism with Regard to Intergovernmental Agreements and Non-Binding Instruments between Member States and Third Countries in the Field of Energy and Repealing Decision No 994/2012/EU' 48 <https://ec.europa.eu/energy/sites/ener/files/documents/1_EN_impact_assessment_part1_v6.pdf> accessed 25 August 2016.

[62] IGA Decision, Article 3(3).

[63] Vienna Convention on the Law of the Treaties (adopted on 23 May 1969) Art 37-54.

[64] European Commission, 'Intergovernmental Agreements in Energy' (2016) <europa.eu/rapid/press-releaseMEMO-16-309en.pdf> accessed 20 August 2016.

[65] Ibid. Only one IGA has been signed after 2012, but some of the IGAs dating back 15-30-years ago will be coming up for renewal soon.

the construction of the South Stream.[66] In particular, the EC considered the IGAs signed between Russia and six EU members at odds with the Third Energy Package.[67] Notably, Russia preferred not to embark in lengthy renegotiations with the countries concerned – it took years to conclude all the agreements – and stopped the project, even though the construction of the infrastructure had already started.

To overcome the problems of *ex post* renegotiation, on 16 February 2016 the Commission presented the Sustainable Energy Security Package, which, *inter alia*, includes modifications to the IGA Decision.[68] The most relevant amendment proposed is the adoption of a mandatory *ex ante* compatibility control by the Commission of the treaties to be signed.[69] Additionally, Member States will have to send their draft IGAs to the Commission before concluding them, and they are obliged not to sign the relevant IGA until the Commission has issued its opinion or the period set out for the Commission to scrutinise each IGA has elapsed.[70] When concluding the proposed intergovernmental

[66] The project was meant to link the EU with Russian gas bypassing Ukraine through pipelines lying under the Black Sea. For an overview of the project see: <http://www.south-stream-transport.com/project/> accessed 20 August 2016. See also chapter I, section 7.

[67] See: Euractiv, 'South Stream Bilateral Deals Breach EU Law, Commission Says' (2013) <http://www.euractiv.com/section/competition/news/south-stream-bilateral-deals-breach-eu-law-commission-says/> accessed 20 August 2016. All agreements concerning the South Stream were cases of established incompatibility between BITs and EU law after the accession to the EU of the signatories. Pursuant to Article 351(2) TFEU: 'To the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude'.

[68] European Commission, 'Towards Energy Union: The Commission Presents Sustainable Energy Security Package' (2016) <http://europa.eu/rapid/press-releaseIP-16-307en.htm> accessed 20 August 2016. See section 3.2.

[69] Ibid.

[70] Pursuant to Article 5 of the proposal to reform the IGA Decision, the Commission shall inform the Member State concerned of any doubts it may have as to the compatibility of the draft intergovernmental agreement or amendment within six weeks of the date of notification of the complete draft intergovernmental agreement or amendment. In this case, it shall inform the Member State concerned of its opinion on the compatibility with Union law of the draft intergovernmental agreement or amendment concerned within 12 weeks of the date of notification.

agreement or amendment, Member States will have to take full account of the Commission's opinion.

Differently from the IGA Decision, the new proposal also requires the notification of non-binding instruments.[71] Even if legally non-binding, such instruments can be used to set out a detailed framework for energy infrastructure and energy supply, for example in the form of Memorandum of Understanding, or other soft law mechanisms. In this respect, non-binding instruments can have an impact on the internal energy market similar to intergovernmental agreements as their implementation might result in a violation of EU law.[72]

The final version of the proposal was adopted in April 2017.[73] The new decision, just like the IGA Decision, does not cover commercial agreements between companies. The current control mechanism of the commercial contracts – especially with regard to EU competition law – has not changed.[74]

Along with a positive impact on the EU security of supply, the new IGA decision could also have a positive influence on the business of individual companies involved in energy projects. Possible issues relating to non-compliance with EU law would be tackled at an

[71] Article 2 of the proposal to reform the IGA Decision defines 'non-binding instruments' as 'non-binding arrangement between one or more Member States and one or more third countries, such as a memorandum of understanding, joint declaration, ministerial joint declaration, joint action or joint code of conduct, which contains interpretation of Union law, sets the conditions for energy supply (such as volumes and prices) or the development of energy infrastructures'. See Van Vooren (n 55) 69.

[72] Proposal to reform the IGA Decision, recital 11.

[73] European Parliament and Council Decision 2017/684 of 5 April 2017 On Establishing an Information Exchange Mechanism with Regard to Intergovernmental Agreements and Non-Binding Instruments Between Member States and Third Countries in the Field of Energy and Repealing Decision No 994/2012/EU [2017] OJ L99/17.

[74] See section 4.2.

early stage, and by avoiding cancellation or delay costs, the new IGA decision provides legal certainty to investors and project promoters.[75]

The IGA Decision was issued on the basis of Article 194 TFEU and so is the proposal to reform it. The mandatory *ex-ante* Commission control included under the new proposal entails a shift of competences from Member States to the EU. This action is justified by virtue of the application of the subsidiarity principle, whereby in case of shared competence, the Union can take action only when it is more effective than the action taken at national, regional or local level.[76] Past experience has shown that the *ex-post* control included under the IGA Decision did not work, creating substantial damage for the investment projects concerned and, ultimately, for the EU citizens who could not benefit from the infrastructure envisioned. A preventive check, such as the one outlined in the new IGA Decision, is certainly a 'more effective' option to achieve the compliance of IGAs with EU law.

### 4.2 Commercial Agreements of the EU Market Operators

With the adoption of the new IGA Decision, all Member States concerned will receive the same level of information on cross-border projects. This will help avoiding double investments and infrastructure gaps.[77] However, the IGA Decision is only one piece of a larger puzzle. Indeed, taken alone, it is not enough to secure the gas supply because it

[75] European Commission, 'Intergovernmental Agreements in Energy' (2016) <europa.eu/rapid/press-release_MEMO-16-309en.pdf> accessed 20 August 2016. For a critique, see Valentin Jeutner, 'A Critique of the EU Commission's Proposal Concerning Intergovernmental Energy Agreements' (2016) 5 International Energy Law Review 181-189 <https://ssrn.com/abstract=2911579> accessed 18 June 2017.

[76] Treaty on European Union (TEU), Article 5(3).

[77] European Commission (n 75).

addresses only EU Members and their intergovernmental energy agreements with non-EU countries (inter-state level).

To tackle this issue, the Energy Union strategy adopted in February 2015 indicates that: 'an important element in ensuring energy (and in particular gas) security is full compliance of agreements related to the buying of energy from third countries with EU law'.[78] This was reaffirmed by the European Council on 19 March 2015, when it called for 'full compliance with EU law of all agreements related to the buying of gas from external suppliers, notably by reinforcing transparency of such agreements and compatibility with EU energy security provisions'.[79] With this aim, the EU has planned to adopt a revised Regulation 2010/994/EU on the safeguard security of gas supply (the 'SoS Regulation').[80] This was the first detailed intervention issued as a response to the 2009 Russian-Ukrainian gas crisis, aimed at securing the EU supply of gas. The SoS Regulation repealed Directive 2004/67/EC,[81] which set out basic security of supply standards and emergency mechanisms to be used when markets alone are no longer able to deal adequately with a gas supply disruption.[82] The SoS Regulation requires the designation of a competent authority in charge of guaranteeing energy security, the setup preventive action and emergency plans, the installation of permanent bi-directional capacity on all cross-border interconnections between Member States and the disclosure

[78] European Commission, 'Consultation on the Review of the Intergovernmental Agreements Decision' (2015) <https://ec.europa.eu/energy/en/consultations/consultation-review-intergovernmentalagreements-decision> accessed 22 August 2016.

[79] European Council Conclusions 19-20 March 2015, EUCO 11/15.

[80] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council Concerning Measures to Safeguard the Security of Gas Supply and Repealing Regulation (EU) No 994/2010' COM (2016) 52 final <http://eur-lex.europa.eu/resource.html?uri=cellar:33516200-d4a2-11e5-a4b5-01aa75ed71a1.0018.02/DOC_1&format= PDF> accessed 20 August 2016.

[81] Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas supply [2004] OJ L127/92.

[82] Ibid, Arts 4 and 8.

to national regulatory authorities ('NRAs') of basic information of commercial contracts between undertakings and third suppliers (e.g. duration, contracted total and daily volumes, contracted delivery points), to be notified in aggregate form to the Commission.[83]

At the heart of the 2016 draft proposal to revise the SoS regulation is a call for mandatory regional risk assessments, preventive action and emergency plans. These will follow a pre-set template, be peer-reviewed and require Commission approval.[84] The preventive action and emergency plans will play a key role in the overall coordination mechanism, ensuring that the security of supply framework is correctly applied and that no measure that could jeopardise the security of supply of another Member State, region or the EU as a whole is taken by single EU Member States. Members of the Energy Community will also play a role in this coordination process.[85] Further, in accordance with Articles 122 and 194 TFEU, the proposal introduces a solidarity principle among Member States to ensure the supply of households and essential social services, such as healthcare, in case their supply was affected due to a severe crisis.[86] However, the solidarity mechanism will apply when markets alone are no longer able to deal adequately with a gas supply disruption. Although a call for European solidarity was present in Regulation 994/2010

[83] SoS Regulation, Article 13.

[84] European Commission, 'Security of Gas Supply Regulation' (2016) <http://europa.eu/rapid/press-release_MEMO-16-308_en.htm> accessed 23 August 2016. Accordingly, a peer review team per region composed of experts from Member States and from the European Network of Transmission System Operators for Gas (ENTSOG) will be established.

[85] See footnote 38 for an explanation of the Energy Community.

[86] European Commission (n 79).

and even in its predecessor document, in the new proposal the solidarity principle is now linked to clearly defined obligations for the first time.[87]

The new regulation was published in the Official Journal of the European Union on 28 October 2017 and entered into force on 1 November 2017, except for the provisions relating to the solidarity mechanism which will apply from 1 December 2018.[88] In addition to the above, the text adopted requires gas companies to notify national authorities of all security of supply relevant contracts.[89] These are contracts for more than one year that place more than 28% of the gas consumption in a Member State in the hands of a single third country supplier or of its affiliated companies.[90] Moreover, the Commission and national authorities may ask to scrutinise contracts that do not meet the 28% threshold, if they deem it necessary to assess security of supply, and may request additional information, including contractual information, in non-emergency situations.[91] This information would be added to what companies are already obliged to communicate under the SoS regulation.

As for the IGA Decision, the issuance of the SoS Regulation and its reform are based on Article 194 TFEU and the application of the subsidiarity principle. Given the importance of the matter and the poor results of the first EU intervention (Directive 2004/67/EC),[92]

[87] Ruven Fleming, 'New EU Gas Security of Supply Regulation 2017/1938' (2017) <http://energyandclimatelaw.blogspot.it/2017/10/new-gas-security-of-supply-regulation.html> accessed 25 November 2017.

[88] European Parliament and Council Decision 2017/1938 of 25 October 2017 concerning measures to safeguard the security of gas supply and repealing Regulation (EU) No 994/2010 OJ L 280/17.

[89] Ibid, Article 14.

[90] Ibid.

[91] Ibid.

[92] See SoS Regulation, recital 5.

this piece of legislation has been issued as a regulation, which is directly applicable in the territory of EU MSs.

In any event, a fully-integrated energy market will not be easy to achieve. For example, it took five years to convince Romania (which has sufficient amounts of gas) Bulgaria (which has no gas) and Greece (which has an LNG terminal) to work together.[93] Moreover, the regional approach outlined in the SoS Regulation could, in the end, result in incompatible markets, missing out on the benefits of bringing disparate nations together.[94] Indeed, EU Members widely differ in terms of energy mix and production, and, because of that, the needs of one Member are not always the same as another Member across the continent.

## 5. The Characteristics of the New EU Approach

The 2003 European Security Strategy did not include energy security in its threat assessment, which was dominated by the aftermath of the 9/11.[95] The first attempt to set out a common European energy policy took place in 2006 by means of a Commission's Green Paper,[96] and was followed by a series of policy documents which enhanced the need for a coherent approach *vis-à-vis* third suppliers. This is because the external energy policy is very much the external projection of the internal market, which at that time was

[93] Natasha Georgiou and Andrea Rocco, 'The Energy Union as an Instrument of Global Governance in EU-Russia Energy Relations: From Fragmentation to Coherence and Solidarity' (2016) 9(1) Geopolitics, History and International Relations 257.

[94] Sonja van Renssen, 'Georg Zachmann, Bruegel Institute: The EU Must Go for an Energy Union – or Renationalise Energy Markets' (2015) <http://www.energypost.eu/interview-georg-zachmann-eu-must-go-energy-union-renationalise-energy-markets/> accessed 25 August 2016.

[95] Van Vooren (n 55) 23. European Council, 'European Security Strategy - A Secure Europe in a Better World' EUCO (2003).

[96] European Commission, 'A European Strategy for Sustainable, Competitive and Secure Energy' COM (2006) 105 final.

still under deep construction. The Lisbon Treaty codified most of the policy process that preceded it.[97] This was explicitly recognised in the 2020 programme, where we read:

> A common EU energy policy has evolved around the common objective to ensure the uninterrupted physical availability of energy products and services on the market, at a price which is affordable for all consumers (private and industrial), while contributing to the EU's wider social and climate goals. The central goals for energy policy (security of supply, competitiveness, and sustainability) are now laid down in the Lisbon Treaty.[98]

When carefully analysed, the policy instruments and the related documents that predate the Lisbon Treaty outline a trend towards the security dimension of the EU energy policy. The centralisation of the energy competences to the EU is the key feature of the current approach to the energy sector of the European institutions and finds evidence in the legislation issued after Lisbon, which moves from the clauses of the Treaty and makes a step further. This trend is reflected also in the 2016 legislative proposals analysed in the previous sections of this chapter.

Thanks to the introduction of Article 194 TFEU and the application of the subsidiarity principle, the EU could take more ambitious policies in the energy field such as the Energy Union project, which, as seen above, extends the EU control not only to Member States' actions but also to non-binding measures and to private undertakings' commercial agreements.

[97] Van Vooren (n 55) 32.

[98] European Commission – Directorate General for Energy, 'A Strategy for Competitive, Sustainable and Secure Energy' COM (2010) 639 final.

The new EU approach to the energy sector will certainly impact on the relationship of the Union with third countries. Indeed, the WTO violations described in the previous chapter towards non-EU suppliers partly derived from the objectives of the EU regulation – focused since the first interventions on achieving the internal energy market rather than on securing the EU energy supply[99] – and from the limited powers in the energy field the EU was granted under the Treaties before Lisbon.

As seen in chapter I, deprived of any competence to directly intervene in the energy field, the EU tried to prevent EU and non-EU gas incumbents from using their market power through the regulation of the internal market and competition law enforcement. The completion of an internal market which could guarantee a level-playing field between the market operators was indeed the most important tool to enhance the security of supply of the Union.[100]

The post-Lisbon approach could overcome the lack of coherence towards third countries underlined in Chapter I, because the key aspects of the investments to be made will be increasingly negotiated with one single voice with the support of the EU institutions. Besides, it is worth noting that most of the trade law problems detected in Chapter III about the Gas Directive relate to the potential discrimination of foreign providers operating in the EU territory. With the full implementation of the new measures, the security of the EU energy supply will be guaranteed both at political and at commercial level, without the need to adopt discriminatory internal market rules, through: (i) inter-state negotiation, with the application of new IGA Decision and Regulation 1219/2012,

[99] The Third Energy Package was adopted after the 2006 Commission Green Paper, which put 'competitiveness and the completion of the internal market' as the first EU priority areas for the years to follow. See European Commission (n 96).

[100] Victor Van Hoorn, 'WTO Consistency and Broader Implication for Europe' (2009) 18 European Energy and Environmental Law Review 72.

both concerning the negotiation and conclusion of international agreements; and (ii) company conducts' analysis, through the scrutiny of all security of supply relevant agreements (new SoS Regulation) and the possibility to adopt demand aggregation mechanisms.

Remarkably, the application of the new IGA Decision could indirectly extend the EU *acquis* to third countries. This is another example of export of EU law.[101] Indeed, the request for compliance with EU law as condition precedent for the signature of IGAs between a Member State and a third country forces third States to abide by EU law and its provisions. It is worth noting that the new IGA Decision does not require only the respect for EU competition rules, but also demands the compliance with all EU legislation by the IGA to be negotiated, extending this obligation to non-binding instruments.[102] The attempt to export the EU principles to neighbouring countries, typical of the post-2006 Green Paper period,[103] is based on the assumption that if all States adhere to these principles, then energy relations will improve and the market itself will ensure the security of the gas supply.[104] However, in a break from the past – where the EU action has driven third entities' behaviours – the new IGA charges Member States with the obligation to

[101] See Jorrit J Rijpma and Marise Cremona, 'The Extra-Territorialisation of EU Migration Policies and the Rule of Law' (2007) EUI Working Paper 01/2007 <http://cadmus.eui.eu/bitstream/handle/1814/6690/LAW_2007_01.pdf> accessed 26 March 2018; Directorate-General for External Policies of the Union, *The Extraterritorial Effects of Legislation and Policies in the EU and US* (AFET 2012).

[102] European Parliament and the Council of the European Union, 'Proposal of Decision of the European Parliament and of the Council on Establishing an Information Exchange Mechanism with Regard to Intergovernmental Agreements and non-binding Instruments Between Member States and Third Countries in the Field of Energy and Repealing Decision no 994/2012/EU' COM (2016) 53 final, Article 5.

[103] See Thomas Cottier, Sofya Matteotti-Berkutova and Olga Nartova, 'Third Country Relations in EU Unbundling of Natural Gas Markets: The 'Gazprom Clause' of Directive 2009/73/EC and WTO Law' (2010) NCCR Trade Regulation Working Paper 6/2010, 6; Andrey A Konoplyanik, 'Russia and the Third Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Including non-EU Suppliers) and Consumers' (2011) International Energy Law Review 32; Alexander Jouravlev, 'The Effect of the European Union's Unbundling Provisions on the EU-Russia Gas Relationship and Russia's Accession to the World Trade Organization' (2011) 16 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969502> accessed 17 June 2017.

[104] Victor Van Hoorn (n 100) 55.

make third countries abide by EU rules. MSs are thus treated as 'agents of implementation' of the EU external energy policy. This is a key aspect of the post-Lisbon approach to the energy sector and is reflected also by the choice of the legislative tools chosen: Under the security of supply perspective, the EU substituted a 2004 directive with a directly applicable instrument (SoS Regulation), eliminating the space of manoeuvre for EU Members.

In addition to Article 194 TFEU, which deals specifically with energy, the centralisation of foreign direct investments at the EU level through Article 207 TFEU and Regulation 2012/1219/EU could have a positive impact on EU energy policy. Indeed, the CJEU explained that the exclusive competence of the EU in this area covers almost all aspects of FDIs, excluding only non-direct investments (portfolio investments) and ISDS mechanisms.[105]

In a field of exclusive EU competence, such as FDI, Member States are able to adopt a binding act only 'if so empowered by the Union or for the implementation of Union acts'.[106] Instead, since energy under Article 194 TFEU is a shared competence, MSs are free to conclude international agreements as long as this is in compliance with the rules on competence allocation – i.e. insofar the Union did not rule on the matter.[107] Moreover, pursuant to Article 194(2) TFEU, MSs retain 'the right to determine the conditions for exploiting energy resource, its choice between different energy sources, and the general structure of its supply'.

[105] Court of Justice of the European Union, 'Opinion 2/15 of the Court (Full Court)' (16 May 2017) ECLI:EU:C:2017:376, 238, 304. In section 2.2 we explained a possible way to circumvent the exclusion of ISDS from the EU's FDI competence.

[106] TFEU, Article 2(1).

[107] See, among the others, Robert Schütze and Takis Tridimas, *Principles of European Law* (OUP 2018) 198.

In principle, international energy agreements between the Union and third States would be mixed agreements which are negotiated, concluded and managed jointly by the EU and its MSs.[108] However, as the EU has occupied the field in the areas of electricity and gas to a large extent, it is reasonable to assume that in case of international agreements in these areas, the EU would have exclusive competence by now.[109] This is justified by Article 3 TFEU whereby 'The Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence'.

Therefore, the EU could now sign international energy agreements with third countries both on the basis of the application of Article 194 combined with Article 3 TFEU and on the basis of Article 207 TFEU. Remarkably, the adoption of an international agreement has more burdensome procedures under Article 207 than under Article 194.[110] The dividing line between the two options is the following: to the extent in which the object and main focus of the agreement is to generally increase energy security, EU institutions must rely on Article 194. By contrast, insofar the action of the EU is primarily to facilitate, foster and regulate trade relations with third countries, the EU shall base its action on Article 207.[111]

[108] Panagiotis Delimatsis, 'Services of General Interest and the EU External Energy Policy' (2013) 25 TILEC Discussion Paper 8.

[109] Ibid.

[110] Article 207 requires the application of the procedure set out under Article 218 TFEU with the specific procedural requirements of Articles 207(2) and 207(3). Instead, Article 194 applies the ordinary legislative procedure (Article 194(2)).

[111] Alexander Proells, 'Principles of EU Environmental Law: An Appraisal' in Yumiko Nakanishi, *Contemporary Issues in Environmental Law: The EU and Japan* (Springer 2016) 29.

In light of the above, with the adoption of the Lisbon Treaty, the EU could improve its energy relationships with Russia by facilitating the negotiation of a new agreement substituting the PCA – and its soft commitments – as well as the single BITs signed between EU Members and Russia (as indicated by Regulation 1219/2012).

From the trade law perspective, we have seen that the discrimination towards third countries' providers of Article 11 of the Gas Directive depends to a large extent on whether the issuance of the certification required to operate as transportation system operator ('TSO') in the EU would jeopardize the security of supply of the Member State where the company operates and the security of supply of the Union as a whole.[112] To evaluate the risks related to the security of supply, the relevant NRA takes into account, *inter alia*, the rights and the obligations of the EU in relation to third countries arising from international law (first and foremost, the treaties in force between the Union and the home country of the requesting entity), as well as the specific circumstances of the case.[113]

The negotiation of a detailed BIT governing the energy relationship between the EU and Russia, possible after the Lisbon Treaty, would thus be taken into account for the positive assessment of the relevant NRA. However, this eventuality would not remedy the discriminatory effect of the Gas Directive on the other non-EU countries which have no energy agreement in place with the EU. In addition to that, an eventual EU-Russia agreement, even in accordance with the provisions of the Gas Directive as required by the IGA Decision, would not by default prevent Russia from bringing the Gas Directive before the WTO Dispute Settlement Body ('DSB') to challenge the issues underlined in

[112] Gas Directive, Article 11(3)(b).

[113] Gas Directive, Article 11(3)(b)(i) and (ii).

Chapter III. This is in line with the findings of *Peru – Agricultural Product* case-law.[114] Accordingly, the express or tacit acceptance of EU law made by Russia would not imply *per se* a consent to relinquish its rights to contest the matter before the WTO DSB.[115] The violation of the WTO rules outlined in Chapter III would thus still be relevant and justiciable, unless the EU decided to amend the Gas Directive.[116]

The post-Lisbon centralisation process will be a crucial means to enhance the bargaining power of the EU in relation to the supplier countries sitting at the negotiating table. This was one of the weaknesses of the pre-Lisbon approach which derived from the disjunction between the 'internal energy policy', characterised by the pervasive regulation of the

[114] *Peru — Additional Duty on Imports of Certain Agricultural Products – Report of the Appellate Body* (20 July 2015) WT/DS457/AB/R.

[115] In the case, the Appellate Body disagreed with Peru that the FTA signed with Guatemala, ILC Articles of State Responsibility No. 20 (whereby 'Valid consent by a State to the commission of a given act by another State precludes the wrongfulness of that act in relation to the former State to the extent that the act remains within the limits of that consent') and No. 45 could be considered as 'relevant' to the interpretation of Article 4.2 of the Agreement on Agriculture and Article II(1)(b) of the GATT within the meaning of Article 31(3)(c) of the Vienna Convention, and that the FTA can be considered as a subsequent agreement 'regarding the interpretation' of these WTO provisions within the meaning of Article 31(3)(a) of the Vienna Convention. In particular, the Appellate Body expressed 'reservations as to whether the provisions of the FTA […], which could arguably be construed as to allow Peru to maintain the PRS in its bilateral relations with Guatemala, can be used under Article 31(3) of the Vienna Convention in establishing the common intention of WTO Members underlying the provisions of Article 4.2 of the Agreement on Agriculture and Article II:1(b) […]' (paragraph 5.106). In the Appellate Body view, 'such an approach would suggest that WTO provisions can be interpreted differently, depending on the Members to which they apply and on their rights and obligations under an FTA to which they are parties' (paragraph 5.106). Instead, the Appellate Body underlined that 'the proper routes to assess whether a provision in an FTA that may depart from certain WTO rules is nevertheless consistent with the covered agreements are the WTO provisions that permit the formation of regional trade agreements – namely: Article XXIV of the GATT 1994, or the Enabling Clause as far as agreements between developing countries are concerned, in respect of trade in goods; and Article V of the General Agreement on Trade in Services (GATS) in respect of trade in services' (paragraph 5.107). Then, the Appellate Body recalled the case law on the matter, citing the *Turkey – Textiles* case and underlining that, for a provision to be in compliance with Article XXIV GATT, two cumulative circumstances must be met: '(i) the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union or FTA that fully meets the requirements of Article XXIV; and (ii) that party must demonstrate that the formation of that customs union or FTA would be prevented if it were not allowed to introduce the measure at issue' (paragraph 5.115). In addition to that, the Appellate Body further noted that Article XXIV(4) qualifies customs unions or FTAs only 'agreements of closer integration between the economies of the countries parties to such agreements'.

[116] This would require the substitution of the evaluation criteria set out under Articles 11 and 36 of the Gas Directive with objective rules equal for EU and non-EU entities. Moreover, the revision of the unbundling rules would be necessary in a way not to impose participation limits falling within the prohibition of quantitative restrictions and market access barriers to services.

market operators combined with a strong antitrust enforcement, and the 'external energy policy', characterised by bilateralism and inconsistency, given that the energy field was an exclusive competence of EU Members. In that period, the security of supply of the Union was mainly left to the agreements between EU companies – often acting as representatives of their States – and third countries' suppliers.[117] In this context, the conditions of the commercial agreements signed by market operators depended on the bargaining power of the parties involved, which, in case of European companies, was weakened by the antitrust and the regulatory interventions of the EU institutions. This led to the paradoxical situation in which a more competitive EU internal energy market would worsen the security of supply of the Union because of the diminished bargaining power of the domestic operators *vis-à-vis* their suppliers.[118]

Things seem to have changed after the entry into force of the Lisbon Treaty, with the adoption of a more coherent external approach. Most obviously, it was the economically less powerful Members which have been limited in their negotiation capacities and consequently have been hampered in concluding advantageous investment treaties.[119] However, it is likely that the bargaining power of the EU as a whole will be maximised, resulting in advantages for all EU MSs. Moreover, good deals with clear protections granted to the third parties involved could open the door to significant investments,

[117] We have seen in chapter I, section 5.1.2, that Russia does not always sign bilateral IGAs with its gas importing countries. Russia has signed BITs with the following EU-countries: Austria (1990/1991), Belgium (1989/1991), Bulgaria (1993/2005), Czech Republic (1994), Denmark (1993/1996), Finland (1989/1991), France (1989/1991), Germany (1989/1991), Greece (1993/1997), Hungary (1995/1996), Italy (1996/1997), Lithuania (1999/2004), The Netherlands (1993/1996), Romania (1993/1996) Slovakia (1993/1996), Spain (1990/1991), Sweden (1995/1996), the UK (1989/1991).

[118] Jouravlev underlines that 'the Commission did not go on to evaluate the risks and potential negative impacts of weakened coordination as a result of unbundling, nor how 'missing links' in the delivery of natural gas could affect consumers' in Alexander Jouravlev (n 103) 16.

[119] Kazimirek (n 15) 46.

especially by entities not operating in the energy field, which do not have to abide by the unbundling rules of the Gas Directive (e.g. investment funds).[120]

## 6. Interim Conclusion

In this chapter, we analysed the EU post-Lisbon approach to the energy regulation and outlined its distinctive features. We have underlined that the innovations brought about by the Lisbon Treaty and the resulting regulations could overcome some of the problems of the pre-Lisbon approach described in Chapter I, rebalancing the pre-Lisbon bilateralism by setting up centralised procedures which allow fair negotiations with non-EU countries.

The centralisation of the energy competences in the EU could constitute the basis for a new international agreement in the field (in case of common political will), which supersedes the disparate BITs already signed by EU Members and the mild provisions of the PCA. All of this would be beneficial to the EU, giving coherence to its external energy policy, and would help to guarantee the security of its gas supply.

However, this new approach does not change the problems related to the possible violation of WTO rules outlined in the previous chapter. Unless the EU amended Article 11 of the Gas Directive, Russia still could push for a WTO decision on the case, which is now pending before the DSB.

[120] See chapter II, section 5.

# GENERAL CONCLUSION

> 'Geopolitics is all about leverage. We cannot make ourselves safer abroad unless we change our behaviour at home'[1]

This quotation from the three-time Pulitzer Prize winner and US opinion leader Thomas Friedman, echoes the broad definition of geopolitics that we gave in the introduction of this thesis, where we described geopolitics as a network of interactions of different categories of subjects on a global scale.[2]

This thesis examined the EU-Russia energy relationship from the European perspective and considered the interactions that, as Friedman has observed, form the basis of geopolitical action. In so doing, we have also elucidated the questions posited in the introduction of this thesis.[3]

The previous chapters reviewed the three elements of geopolitical manoeuvring as defined by Friedman: (i) leverage (and how it affects the security of the EU's natural gas supply); (ii) 'behaviour at home' (i.e. EU regulations for the energy industry); and (iii) change of behaviour (i.e. how the adoption of the Lisbon Treaty and the promulgation of the ensuing regulations changed the nature of the EU's leverage and behaviour). In the context of the EU-Russian energy relationship, we have noticed that the high interaction

[1] Thomas Friedman, 'The Big American Leak' (2010) <http://www.nytimes.com/2010/12/05/opinion/05friedman.html> accessed 9 January 2017.

[2] See introduction, section 3.

[3] In section 8 of the introduction, we outlined the following questions: what is the actual impact of the current international legal framework on the energy relationships between the EU and its suppliers? Are the EU measures taken in the natural gas field compliant with the international law rules binding the Union? How did the Lisbon Treaty change the EU approach to the energy regulation?

of the elements outlined above is explained by the strong economic interdependence existing between the two parties. To date, Russian supply is indispensable for the EU as well as European demand is fundamental for Russia.

From a legal perspective, we analysed all the bilateral and multilateral legal instruments that govern the EU-Russia partnership and reached the conclusion that, for the time being, the only legal framework capable of determining the EU-Russia energy relation is provided by the World Trade Organization ('WTO') rules. The absence of a bilateral treaty crystallising a trust-based EU-Russia energy relationship leaves the task of energy regulation to the WTO, whose rules and precepts result from a combination of generally applicable multilateral treaties. Specifically, we focused on the WTO rules governing trade in energy goods and services, the compliance with which is the object of a case before the WTO Dispute Settlement Body involving the EU and Russia.

At the EU level, we focused on Directive 2009/73/EC ('the Gas Directive'), the primary piece of legislation regulating the EU natural gas market, and found that it is likely in breach of WTO rules in relation to its unbundling rules (Article 9) and to the restrictions imposed on non-EU companies (Article 11). Moreover, the Gas Directive seems to discourage investments by domestic and foreign market operators by imposing strict shareholding requirements and leaving a considerable discretion to national regulatory authorities and the European Commission regarding unbundling and third party access exemptions for new energy projects. In the end, this could go against the security objectives of the Union.

The foregoing findings give Russia a powerful weapon that it can wield in favour of Gazprom, which is seeking to expand into midstream and downstream markets in the EU.

Failure to comply with a WTO Dispute Settlement Body's ruling permits recourse of Russia to two remedies: voluntary compensation and suspension of concessions and other obligations, in accordance with Article 22 of the WTO Dispute Settlement Understanding.[4] Besides, the possibility of putting the third country clause and ownership unbundling out of action would have a symbolic meaning, since the European Commission has strongly supported the adoption of these provisions.[5]

Notwithstanding to the above, Russia does not seem willing to pull the trigger on the WTO adjudication, at least for now. The threat of a WTO litigation may be used as a bargaining chip with the EU Commission in the Gazprom antitrust case.[6] This might explain the silence around the WTO case since the filing of the request for consultation in 2014. If true, the WTO case could be interpreted as another Russian retaliation against the EU's gas policy, after the adoption of internal legislation aimed at hampering the EU antitrust investigation against Gazprom.[7] Once the antitrust investigation has concluded,

[4] Pursuant to Article 22 of the WTO Dispute Settlement Understanding: '1. Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements. 2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.'

[5] See Chapter II, section 2.1.4.

[6] Murphy shows that the European Commission uses EU competition law for geopolitical purports. See Aisling Murphy, 'Juggling Geopolitics and Competition Law: An Analysis of the Role Geopolitics Plays in the Application of Competition Law in Upstream Gas Contracts' (2014) <https://www.coleurope.eu/system/files_force/research-paper/bm> accessed 6 January 2018.

[7] See chapter I, section 6.1.2.

we will be able to evaluate the effectiveness of the WTO threat and the validity of the speculation we made.

A study similar to that made on the gas market could then be made on the EU electricity market given that Directive 2009/72/EC, part of the Third Energy Package, sets out equivalent obligations to those provided under the Gas Directive for third-country electricity suppliers. Similarly, the electricity market is characterised by a significant cross-border trade between Russia and some Eastern European countries.[8] This could lead to the opening of a WTO case such as the one seen in case of natural gas.

With the Lisbon Treaty, the EU adopted a radically different approach to the energy sector. Thanks to the introduction in the TFEU of a specific section on energy and the extension of EU competences under the Common Commercial Policy – which currently covers foreign direct investments – the EU can now negotiate with its energy partners on equal footing. In this way, the EU could overcome the bilateralism and the inconsistencies characterising the pre-Lisbon period, paving the way for a more coherent external energy approach.

The post-Lisbon energy legislation focuses on the security of supply, through the regulation of EU Members' energy agreements (through the IGA Decision and its amendments) and the scrutiny of commercial agreements between undertakings (through the SoS Regulation and its amendments). The measures adopted differ from pre-Lisbon

[8] The provisions on unbundling and the third country clause laid down under the electricity and the gas directives are equivalent. An example of significant cross-border trade of electricity between EU Members and third countries can be found between Lithuania and Russia. See Monika Kokstaite, 'Lithuania's Energy Transition at a Crossroads' (2017) <https://energytransition.org/2017/09/lithuanias-energy-transition-at-a-crossroads/> accessed 18 April 2018.

legislation – which targeted the internal market, such as the Gas Directive – and are based on the extensive application of the subsidiarity principle, which, combined with Article 194 TFEU, is the cornerstone of the new EU energy policy. This approach is reflected also in the recent proposal to amend the Gas Directive, currently under discussion.[9]

The centralisation approach taken by the EU theoretically secures more compliance with WTO principles because all aspects related to non-EU companies can be regulated *ex ante* with the State of origin (through bilateral treaties negotiated by the Commission and intergovernmental agreements in compliance with EU law principles) without the need to adopt discriminatory market behaviours, such as the ones described in Chapter III.

The post-Lisbon centralisation process cannot succeed without the application of the principle of cooperation set out under Article 4(3) TFEU, which today is regarded as the panacea for cases regarding the division of powers between the EU and its Member States.[10] Indeed, cooperation is essential in ensuring coherence in the external action and the international representation of the EU, eliminating any incompatibility between EU law and the actions made or the agreements signed by MSs and third countries.[11] For this reason, the legislative interventions after the Lisbon Treaty specifically mandate

[9] European Commission, 'Commission proposal for a Directive amending Directive 2009/73/EC' COM (2017) 660. The proposal made aims at clarifying the applicability of the Gas Directive in the case of pipelines entering the European Union from third countries. The EC underlines that 'following legal analysis' of the EC legal service - dated 27 September 2017 - existing pipelines connecting the EU to third countries fall outside the scope of the Gas Directive. The proposal extends the provisions of the Gas Directive also to those pipelines. Again, this proposal does not seem to be a suitable tool to guarantee foreign investors. The EU itself, through Commissioner Sefcovic, warned Gazprom that this proposal could impact on the Nord Stream 2 pipeline. In particular, the Commissioner ironically affirmed 'I would really think twice, or many more times [to invest in Nord Stream 2], simply because there are a lot of uncertainties'. See Andrew Rettman, 'Russia Pipeline Is Investment Risk, EU Commissioner Warns' (2017) <https://euobserver.com/energy/140404> accessed 12 April 2018.

[10] Leal-Arcas (n 6) 30.

[11] Delimatsis (n 108) 8.

obligations of consultation and information.[12] In this respect, the CJEU has underlined that EU MSs and institutions are not only expected to try their best to inform and consult one another but also 'must' comply with these procedural obligations.[13] Remarkably, the centralisation process which characterises the post-Lisbon approach reflects the worldwide tendency to regulate the energy matters at the supra-national level, which we described in the introduction of this work. In principle, this process allows the EU to become one of the leading parties of the international energy arena, as it can negotiate the energy needs of 500 million high-spending consumers. This is key to put downward pressure on the prices negotiated with suppliers and, consequently, enhance the welfare and the security of final consumers.

From a business perspective, the reason why Gazprom still holds a dominant position – Gazprom's gas supplies to Europe and Turkey reached an all-time record in 2017 – is simply because it sells its natural gas at highly competitive prices.[14] With the construction of the Nord Stream and the plan to double its capacity through the Nord Stream 2, Russia

[12] See for example Article 6 of Regulation 1219/2012/EU, entitled 'Duty of Cooperation' and recital 7 of the proposal for the new IGA Decision.

[13] Case C-459/03 *Commission v Ireland* [2006] ECR I-4635 para 59.

[14] Russia's gas exports to Europe and Turkey rose by 8.1% to a record high 193.9 billion cubic meters (Bcm) in 2017. See Reuters, 'Russian Gas Exports to Europe Hit All-Time High in 2017' (2018) <https://www.epmag.com/russian-gas-exports-europe-hit-all-time-high-2017-1676781> accessed 15 April 2018. See also Danila Bochkarev, 'Gazprom Plays Ball: The Depoliticization of the European Gas Market' (2017) <http://energypost.eu/depoliticization-european-gas-market/> accessed 16 June 2017. For an accurate analysis of Gazprom pricing policies see James Henderson and Jack Sharples, 'Gazprom in Europe – Two 'Anni Mirabiles', but Can It Continue?' (2017) Oxford Institute for Energy Studies, 3 <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2018/03/Gazprom-in-Europe-%E2%80%93-two-Anni-Mirabiles-but-can-it-continue-Insight-29.pdf> accessed 16 April 2018.

could sell even more gas to the EU and benefit from the transit fees savings normally due to Ukraine.[15]

Whether piped via Nord Stream or through other routes, Russian gas can be priced more cheaply than liquefied natural gas ('LNG'), which, in addition to the domestic price of gas, includes the cost of liquefaction, ocean transportation, and regasification.[16] The ability to procure non-Russian sourced gas from cargoes allows the EU to use LNG as a 'credible threat' only if Russian piped gas becomes too expensive.[17] This essentially lowers prices for Russian gas and puts a ceiling on Russian piped gas with respect to internationally sourced LNG.[18]

Gazprom's current market behaviour is part of a precise non-confrontational strategy towards the EU institutions, which allows the company to operate stably in the EU

[15] In 2015 Gazprom paid to Naftogaz, the Ukraine gas monopolist, $1.7bnl transit fees for transiting 64.1 bcm of Russian natural gas to the EU. See Thierry Bros, 'Has Ukraine Scored an Own-Goal with its Transit Fee Proposal?'(2016) Oxford Institute for Energy Studies, 1 <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2016/11/Has-Ukraine-scored-an-own-goal-with-its-transit-fee-proposal.pdf> accessed 5 January 2018.

[16] Nathalie Hinchey and Anna Mikulska, 'LNG Versus Russian Gas in Central and Eastern Europe: Playing Poker on A Continental Scale' (2017) <https://www.forbes.com/sites/thebakersinstitute /2017/08/24/lng-versus-russian-gas-in-central-and-eastern-europe-playing-poker-on-a-continentalscale/#36de1ea22c3a> accessed 5 January 2018.

[17] EU shale gas production cannot be considered as a valuable substitute of piped gas. See Arthur Neslen and Frédéric Simon, 'Europe Abandons Hopes of US-Style Shale Gas Revolution' (2016) <https://www.euractiv.com/section/trade-society/news/europe-abandons-hopes-of-us-style-shale-gas-revolution/> accessed 3 March 2018. Nowadays, LNG costs some 30% more than Gazprom's gas in Europe supplied through its 'most expensive' route, via Ukraine. See Elena Mazneva and Anna Shiryaevskaya, 'Putin's Russia Seen Dominating European Gas for Two Decades' (2017) <https://www.bloomberg.com/news/articles/2017-03-01/putin-s-russia-seen-dominating-european-energy-for-two-decades> accessed 12 November 2017.

[18] Nathalie Hinchey and Anna Mikulska, 'LNG Versus Russian Gas in Central and Eastern Europe: Playing Poker on a Continental Scale' (2017) <https://www.forbes.com/sites/thebakersinstitute/2017/08/24/lng-versus-russian-gas-in-central-and-eastern-europe-playing-poker-on-a-continental-scale/#36de1ea22c3a> accessed 7 January 2018. As underlined by Henderson and Sharples, EU politicians concerned by the current market share of Gazprom in EU imports face a dilemma, since it is difficult to impose restrictions on a competitive source of energy when the European Commission and national governments have spent 20 years creating a liberalised market to encourage lower prices for consumers. See James Henderson and Jack Sharples (n 14) 16.

market, while consolidating its position in the upstream market and investing in the long-term diversification of its business. Indeed, because of time constraints the company faces the impossibility to diversify its demand side in the short-term and will operate its first pipeline to China only from December 2019.[19] For these reasons, the EU is still vital for the company's business and, consequently, for Russia's GDP. The non-confrontational attitude of Gazprom is witnessed by two other facts: the 2017 decision to settle the EU antitrust case, offering commitments to the European Commission in a way to avoid possible antitrust sanctions;[20] and the sale of the stakes held in European TSOs to abide by the Gas Directive, which find in the Lithuanian Lietuvos Dujos a case in point.[21]

In the light of the above, lacking any strong bilateral commitment, it seems that to date EU-Russia energy relationships are still driven by market-based mechanisms and opportunity reasons. This scenario could change only with the signature of a new agreement with a balanced regulation of the respective stances of the parties. In this respect, in a break with the past, the post-Lisbon approach seems to offer the right tools

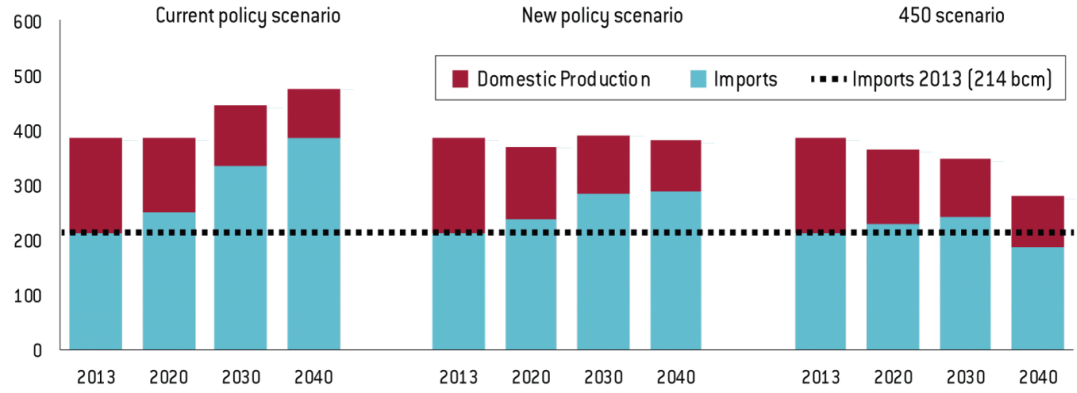
[19] OAO Gazprom, 'Press Release: Russian Gas Supplies to China via Power of Siberia to Start in December 2019' (2017) <http://www.gazprom.com/press/news/2017/july/article340477/> accessed 26 November 2017.

[20] OAO Gazprom, 'Proposals for Commitments – COMP/39.816 Gazprom Commitments under Article 9 of Council Regulation No. 1/2003' (2017) <http://ec.europa.eu/competition/antitrust/cases/g2/gazprom_commitments.pdf> accessed 26 November 2017. 10% of the global turnover of the company is the maximum fine which can be imposed by the European Commission to sanction the breach of EU antitrust rules. At the time of writing (April 2017), the case is not closed yet, even though it seems the parties are near to settle. See Foo Yun Chee and Alissa de Carbonnel, 'Exclusive: Gazprom Set to Gain EU Antitrust Approval with Concessions – Sources' (2018) <https://www.reuters.com/article/us-eu-gazprom-antitrust-exclusive/exclusive-gazprom-set-to-gain-eu-antitrust-approval-with-concessions-sources-idUSKCN1HA1V4> accessed 17 April 2018.

[21] Linas Jegelevicius, 'Gazprom Drops One Arbitration Case Against Lithuania' (2015) <https://www.naturalgasworld.com/gazprom-lithuania-arbitration-case-23046> accessed 27 November 2017.

to achieve a new equilibrium in the EU-Russia energy relationship. This is a marked difference between the pre and the post Lisbon approaches.

Figure 4: EU Production and Imports: Different Scenarios (Tagliapietra and Zachmann, Bruegel Institute)




The possibility of negotiating with one voice is key for the EU. All available market data show that the EU will be increasingly dependent on foreign sources of gas in the future. According to BP, overall indigenous production of gas in Europe (EU plus Norway) has decreased from 299.5 bcm in 2004 to 236 bcm in 2016 (out of an overall consumption of about 400 bcm).[22] This number could fall further to 170 bcm in 2035.[23] The International Energy Agency forecasts that, even with the adoption of the energy efficiency and green production already planned,[24] in the near future the EU will need massive natural gas

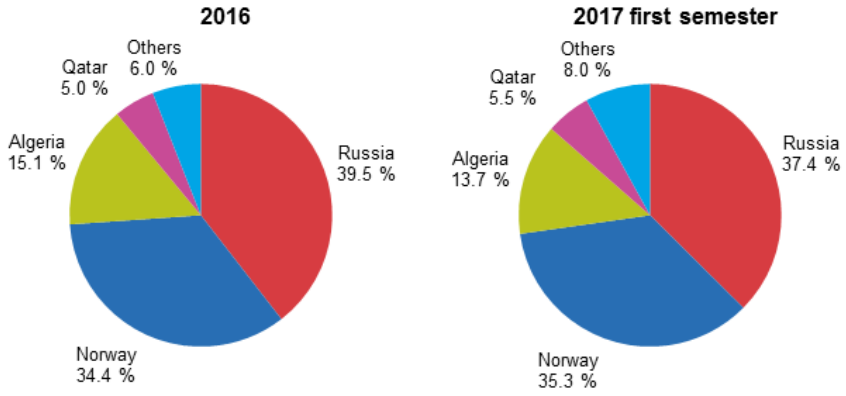
[22] British Petroleum, 'BP Statistical Review of World Energy June 2017' (2017) 30 <https://www.bp.com/content/dam/bp/en/corporate/pdf/energy-economics/statistical-review-2017/bp-statistical-review-of-world-energy-2017-full-report.pdf> accessed 6 January 2018; European Commission, 'Quarterly Report on European Gas Markets' (2016) <https://ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q4_2015-q1_2016.pdf> accessed 10 January 2018. See also Henderson and Sharples (n 14) 9.

[23] Cedigaz, 'Medium and Long-Term Natural Gas Outlook' (2015) <http://www.snam.it/opencms/handle404?exporturi=/export/sites/snam/repository/media/energymorning/allegati_energy_morning/20150217_1.pdf> accessed 6 January 2018.

[24] International Energy Agency, 'World Energy Outlook 2016' (2016) 32-37 <https://www.iea.org/media/publications/weo/WEO2016Chapter1.pdf> accessed 6 January 2018. The 'Current Policies Scenario' depicts a path for the global energy system shorn of the implementation of any new policies or measures beyond those already supported by specific implementing measures in place as of mid-2016. The '450 Scenario', considers all the measures necessary to achieve the objective of limiting the average global

imports to fuel its economy (see Figure 4, Tagliapietra and Zachmann). Given that the choice of a commodity is mainly driven by its price, it is likely that Russia will be the main gas supplier of the Union also in the next 25 years.[25] Norway, which to date is the second largest EU supplier (see Figure 5 below, Eurostat),[26] in a few years will face declining production of gas,[27] and its state-owned company, Statoil, rather than focusing on the exploitation of new gas fields, recently announced massive investments in renewables sources of energy in the years to come.[28]

Figure 5: Breakdown of EU Natural Gas Imports, 2017 (Eurostat)




temperature increase in 2100 to 2 degrees Celsius above pre-industrial levels. The charts have been elaborated by Simone Tagliapietra and Georg Zachmann in 'Rethinking the security of the European Union's gas supply' (2016) Bruegel Policy Contributions <http://bruegel.org/2016/01/rethinking-the-security-of-the-european-unions-gas-supply/> accessed 8 January 2018.

[25] EurAsia Daily, 'What Will Russia Lose Refusing from Gas Pipelines Bypassing Ukraine**?**' (2017) <https://eadaily.com/en/news/2017/08/04/what-will-russia-lose-refusing-from-gas-pipelines-bypassing-ukraine> accessed 10 January 2018. Russia estimated reserves amount to 1,688 trillion cubic feet (Tcf) (approximately 23850 billion cubic metres), as of January 2017. See US Energy Information Administration, 'Russia' (2017) <https://www.eia.gov/beta/international/analysis.cfm?iso=RUS> accessed 27 November 2017.

[26] Eurostat, 'EU Imports of Energy Products - Recent Developments' (2017) <http://ec.europa.eu/eurostat/statistics-explained/index.php/EU_imports_of_energy_products_-_recent_developments> accessed 7 January 2018.

[27] Marshall Hall, 'Norwegian Gas Exports: Assessment of Resources and Supply to 2035' (2018) Oxford Institute for Energy Studies Paper 128, 2 <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2018/03/Norwegian-Gas-Exports-Assessment-of-Resources-and-Supply-to-2035-NG-127.pdf> accessed 7 April 2018.

[28] Jude Clemente, 'Norway's Natural Gas Problems Help U.S. LNG in Europe' (2016) <https://www.forbes.com/sites/judeclemente/2016/03/02/norways-natural-gas-problems-help-u-s-lng-in-europe/#42a1dc551bcf> accessed 6 January 2018.

Therefore, except for an unexpected break in the international order (which as explained in the introduction may occur due to technological, economic or political reasons), it appears that interdependence will be a key feature characterising the EU-Russia energy future. This is in line with International Energy Agency's forecasts, which elect natural gas as 'the clear winner for the next 25 years' together with wind and solar powers.[29]

However, we must keep in mind that while the EU security of gas supply debate to date is almost exclusively focused on Russia, it is in reality much wider because it potentially encompasses all EU gas supplies, which might be interrupted for either technical or geopolitical reasons – Libya is a recent example, due to the Arab Spring unrest.[30] Because of different internal energy mixes and exposures towards Russia' supply,[31] some EU Members may be more vulnerable in case of gas shortages from countries other than Russia. For this reason, security of gas supply is an issue that concerns all EU Members, notwithstanding their actual dependence from Russian imports. Therefore, the EU should think of security of supply 'globally' and should not be overly concerned by the presence of a few key suppliers in its import portfolio, as it has at its disposal alternative supplies that can flexibly and rapidly be employed in case of unexpected shortages.[32]

[29] International Energy Agency, 'World Energy Outlook 2016 Sees Broad Transformations in the Global Energy Landscape' (2016) <https://www.iea.org/newsroom/news/2016/november/world-energy-outlook-2016.html> accessed 7 January 2018.

[30] Ali Shuaib and Marie-Louise Gumuchian, 'Libya Stops Gas Exports to Italy After Militia Fight' (2013) <https://www.reuters.com/article/us-libya-gas-italy/libya-stops-gas-exports-to-italy-after-militia-fight-idUSBRE92203A20130303?irpc=932> accessed 7 January 2018.

[31] See Chapter I, table 1.

[32] See chapter III, section 7, where we took the example of Czech Republic and Poland and the way they exploit new interconnection capacity to avoid possible gas shortages.

With that in mind, from a legal perspective, the EU should fully profit from the tools made available under the Lisbon Treaty and the ensuing regulations to consolidate the partnerships established with all its energy suppliers and prevent security of supply disruptions. Among the other measures to take, the EU should:

(i) sign intergovernmental investment agreements with its current and potential supplier countries, which set out precise market access standards, investment incentives and guarantees for the undertakings willing to operate in the territory of the other party;[33]

(ii) keep on investigating market operators' commercial agreements (through which third countries can pursue their foreign policy objectives) in a way to guarantee their transparency, the absence of anti-competitive measures and backup mechanisms in case of energy shortages;

(iii) fortify energy cooperation (e.g. in the form of memorandum of understanding, joint declaration etc.) with neighbouring countries, and, in particular, increasing the engagement with the Union for the Mediterranean – also in light of the possibility to exploit offshore gas discoveries between Egypt and Cyprus.[34]

These actions will have to go along with business initiatives aimed at securing EU energy supply either directly (e.g. the development of the Southern Corridor)[35] or indirectly (e.g.

[33] These agreements could be characterised by the limitation of dispute settlement provisions as described in chapter IV, section 2.2.

[34] Tareq Baconi, 'Pipelines and Pipedreams: How the EU Can Support a Regional Gas Hub in the Eastern Mediterranean' (2017) <http://www.ecfr.eu/publications/summary/pipelines_and_pipedreams_how_the_eu_can_support_a_regional_gas_hub_in_7276> accessed 8 January 2018.

[35] The 'Southern Gas Corridor' is a term used to describe planned infrastructure projects aimed at improving the security and diversity of the EU's energy supply by bringing natural gas from the Caspian region to Europe. See Trans Adriatic Pipeline, 'Southern Gas Corridor' (2018) <https://www.tap-ag.com/the-pipeline/the-big-picture/southern-gas-corridor> accessed 8 April 2018.

the exploitation of infrastructure unused capacity,[36] investments in research and technology, a further push to renewable energy production and energy efficiency). In this respect, the Energy Union strategy seems pave the way for the achievement of EU security of supply interests, albeit its implementation by EU Members will require future analysis.

With specific focus on Russia, the EU should firstly demonstrate the political will to renegotiate a new Partnership and Cooperation Agreement, now stopped as a sanction for the 2014 occupation of Crimea. The new agreement should cover not only trade but also investments, with the guarantees typical of BITs (most favoured nation, national treatment, fair and equitable treatment, prohibition of unlawful expropriations, guarantee of free transfer of funds, ISDS mechanisms). As seen in Chapter I, to date there is not a specific protection for the investments made after Russia's termination of the Energy Charter Treaty. Until the conclusion of a new agreement, WTO rules would still be the only suitable legal tool to guide EU-Russia energy relationships.

In the opinion of the author, a common EU energy policy, facilitated by the Lisbon Treaty, is indeed the only a way to surpass the tit-for-tat behaviours seen in the past, guaranteeing a framework to secure investments both for EU and Russian companies willing to invest in the territory of the other party. This would be coherent with the Energy Union plan – one of the most important pledges of the current European executive – which put 'security of the energy supply' as the cornerstone of the EU energy strategy, and would be

[36] Simone Tagliapietra and Georg Zachmann (n 24).

beneficial also for Russia, since it would secure the operation of Gazprom in Europe.[37] The possibility to negotiate with one party only representing the stances of all EU countries could make it easier both for the EU and for Russia to strike a proper balance between their sovereign interests and the protection of the investments made abroad by their nationals. This negotiation path would share the same logic adopted by the EU in the agreements with Canada (CETA) and Singapore (EUSFTA). This process will imply the restart of the negotiations stopped and the non-adoption of harsher sanctions against Russia, such as the ones voted by the US Congress in July 2017 and the others subsequently envisioned.

Clearly, this proposal could call into question the EU alliance with Washington over the Ukrainian crisis which, in accordance with the definition of geopolitics we gave in the introduction of this work, extends to the interests and relations between the EU and the US which go beyond the energy field. However, given the strategic importance of Russian gas for the current and future energy security of the EU – a situation markedly different from the one of the US, which have no energy imports from Russia and are likely to become a natural gas net exporter in the next years – [38] a more pragmatic approach by the European institution seems to be appropriate for the benefit of EU citizens.

[37] As seen in chapter I, section 3, Russian energy investments in the EU are of vital importance for the country. On the other side, roughly 75% of Russia's FDIs stem from the EU and do not find sufficient protection. See European Commission, 'Countries and Regions' (2017) <http://ec.europa.eu/trade/policy/countries-and-regions/countries/russia/> accessed 23 April 2017.

[38] US Energy Information Administration, 'US Natural Gas Imports by Country' (2017) <https://www.eia.gov/dnav/ng/ng_move_impc_s1_a.htm> accessed 20 April 2018. International Energy Agency, 'World Energy Outlook 2017' (2017) <https://www.iea.org/weo2017/> accessed 20 April 2018.

# APPENDIX – DIRECTIVE 2009/73/EC

**(selected Articles)**

**DIRECTIVE 2009/73/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**of 13 July 2009**

**concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC**

**(Text with EEA relevance)**

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 47(2) and Articles 55 and 95 thereof,

Having regard to the proposal from the Commission,
Having regard to the opinion of the European Economic and Social Committee ([1]),
Having regard to the opinion of the Committee of the Regions ([2]),
Acting in accordance with the procedure laid down in Article 251 of the Treaty ([3]),

Whereas:

(1) The internal market in natural gas, which has been progressively implemented throughout the Community since 1999, aims to deliver real choice for all consumers of the European Union, be they citizens or businesses, new business opportunities and more cross-border trade, so as to achieve efficiency gains, competitive prices, and higher standards of service, and to contribute to security of supply and sustainability.

(2) Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas ([4]) has made a significant contribution towards the creation of such an internal market in natural gas.

(3) The freedoms which the Treaty guarantees the citizens of the Union — *inter alia*, the free movement of goods, the freedom of establishment and the freedom to provide services — are achievable only in a fully open market, which enables all consumers freely to choose their suppliers and all suppliers freely to deliver to their customers.

(4) However, at present, there are obstacles to the sale of gas on equal terms and without discrimination or disadvantages in the Community. In particular, non-discriminatory network access and an equally effective level of regulatory supervision in each Member State do not yet exist.

(5) The Communication of the Commission of 10 January 2007 entitled 'An Energy Policy for Europe' highlighted the importance of completing the internal market in natural gas and of creating a level playing field for all natural gas undertakings established in the Community. The Communications of the Commission of 10 January 2007 entitled 'Prospects for the internal gas and electricity market' and 'Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report)' showed that the present rules and measures do not provide the necessary framework for achieving the objective of a well-functioning internal market.

(6) Without effective separation of networks from activities of production and supply (effective unbundling), there is a risk of discrimination not only in the operation of the network but also in the incentives for vertically integrated undertakings to invest adequately in their networks.

(7) The rules on legal and functional unbundling as provided for in Directive 2003/55/EC have not, however, led to effective unbundling of the transmission system operators. At its meeting on 8 and 9 March 2007, the European Council therefore invited the Commission to develop legislative proposals for the 'effective separation of supply and production activities from network operations'.

(8) Only the removal of the incentive for vertically integrated undertakings to discriminate against competitors as regards network access and investment can ensure effective unbundling. Ownership unbundling, which implies the appointment of the network owner as the system operator and its independence from any supply and production interests, is clearly an effective and stable way to solve the inherent conflict of interests and to ensure security of supply. For that reason, the European Parliament, in its resolution of 10 July 2007 on prospects for the internal gas and electricity market ([5]) referred to ownership unbundling at transmission level as the most effective tool by which to promote investments in infrastructure in a non-discriminatory way, fair access to the network for new entrants and transparency in the market. Under ownership unbundling, Member States should therefore be required to ensure that the same person or persons are not entitled to exercise control over a production or supply undertaking and, at the same time, exercise control or any right over a transmission system operator or transmission system. Conversely, control over a transmission system or transmission system operator should preclude the possibility of exercising control or any right over a production or supply undertaking. Within those limits, a production or supply undertaking should be able to have a minority shareholding in a transmission system operator or transmission system.

(9) Any system for unbundling should be effective in removing any conflict of interests between producers, suppliers and transmission system operators, in order to create incentives for the necessary investments and guarantee the access of new market entrants under a transparent and efficient regulatory regime and should not create an overly onerous regulatory regime for national regulatory authorities.

(10) The definition of the term 'control' is taken from Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) ([6]).

(11) Since ownership unbundling requires, in some instances, the restructuring of undertakings, Member States that decide to implement ownership unbundling should be granted additional time to apply the relevant provisions. In view of the vertical links between the electricity and gas sectors, the unbundling provisions should apply across the two sectors.

(12) Under ownership unbundling, to ensure full independence of network operation from supply and production interests and to prevent exchanges of any confidential information, the same person should not be a member of the managing boards of both a transmission system operator or a transmission system and an undertaking performing any of the functions of production or supply. For the same reason, the same person should not be entitled to appoint members of the managing boards of a transmission system operator or a transmission system and to exercise control or any right over a production or supply undertaking.

(13) The setting up of a system operator or a transmission operator that is independent from supply and production interests should enable a vertically integrated undertaking to maintain its ownership of network assets whilst ensuring an effective separation of interests, provided that such independent system operator or such independent transmission operator performs all the functions of a system operator and detailed regulation and extensive regulatory control mechanisms are put in place.

(14) Where, on 3 September 2009, an undertaking owning a transmission system is part of a vertically integrated undertaking, Member States should therefore be given a choice between ownership unbundling and setting up a system operator or transmission operator which is independent from supply and production interests.

(15) To preserve fully the interests of the shareholders of vertically integrated undertakings, Member States should have the choice of implementing ownership unbundling either by direct divestiture or by splitting the shares of the integrated

undertaking into shares of the network undertaking and shares of the remaining supply and production undertaking, provided that the requirements resulting from ownership unbundling are complied with.

(16) The full effectiveness of the independent system operator or independent transmission operator solutions should be ensured by way of specific additional rules. The rules on the independent transmission operator provide an appropriate regulatory framework to guarantee fair competition, sufficient investment, access for new market entrants and the integration of gas markets. Effective unbundling through the independent transmission operator provisions should be based on a pillar of organisational measures and measures relating to the governance of transmission system operators and on a pillar of measures relating to investment, connecting new production capacities to the network and market integration through regional cooperation. The independence of the transmission operator should also, *inter alia*, be ensured through certain 'cooling-off' periods during which no management or other relevant activity giving access to the same information as could have been obtained in a managerial position is exercised in the vertically integrated undertaking. The independent transmission operator model of effective unbundling is in line with the requirements laid down by the European Council at its meeting on 8 and 9 March 2007.

(17) In order to develop competition in the internal market in gas, large non-household customers should be able to choose their suppliers and enter into contracts with several suppliers to secure their gas requirements. Such customers should be protected against exclusivity clauses, the effect of which is to exclude competing or complementary offers.

(18) A Member State has the right to opt for full ownership unbundling in its territory. Where a Member State has exercised that right, an undertaking does not have the right to set up an independent system operator or an independent transmission operator. Furthermore, an undertaking performing any of the functions of production or supply cannot directly or indirectly exercise control or any right over a transmission system operator from a Member State that has opted for full ownership unbundling.

(19) Under this Directive different types of market organisation will exist in the internal market in natural gas. The measures that Member States could take in order to ensure a level playing field should be based on overriding requirements of general interest. The Commission should be consulted on the compatibility of the measures with the Treaty and Community law.

(20) The implementation of effective unbundling should respect the principle of non-discrimination between the public and private sectors. To that end, the same person should not be able to exercise control or any right, in violation of the rules of ownership unbundling or the independent system operator option, solely or jointly, over the composition, voting or decision of the bodies of both the transmission system operators or the transmission systems and the production or supply undertakings. With regard to ownership unbundling and the independent system operator solution, provided that the Member State in question is able to demonstrate that the requirement is complied with, two separate public bodies should be able to control production and supply activities on the one hand and transmission activities on the other.

(21) Fully effective separation of network activities from supply and production activities should apply throughout the Community to both Community and non-Community undertakings. To ensure that network activities and supply and production activities throughout the Community remain independent from each other, regulatory authorities should be empowered to refuse certification to transmission system operators that do not comply with the unbundling rules. To ensure the consistent application of those rules across the Community, the regulatory authorities should take utmost account of the Commission's opinion when the former take decisions on certification. To ensure, in addition, respect for the international obligations of the

Community and solidarity and energy security within the Community, the Commission should have the right to give an opinion on certification in relation to a transmission system owner or a transmission system operator which is controlled by a person or persons from a third country or third countries.

(22) The security of energy supply is an essential element of public security and is therefore inherently connected to the efficient functioning of the internal market in gas and the integration of the isolated gas markets of Member States. Gas can reach the citizens of the Union only through the network. Functioning open gas markets and, in particular, the networks and other assets associated with gas supply are essential for public security, for the competitiveness of the economy and for the well-being of the citizens of the Union. Persons from third countries should therefore only be allowed to control a transmission system or a transmission system operator if they comply with the requirements of effective separation that apply inside the Community. Without prejudice to the international obligations of the Community, the Community considers that the gas transmission system sector is of high importance to the Community and therefore additional safeguards are necessary regarding the preservation of the security of supply of energy to the Community to avoid any threats to public order and public security in the Community and the welfare of the citizens of the Union. The security of supply of energy to the Community requires, in particular, an assessment of the independence of network operation, the level of the Community's and individual Member States' dependence on energy supply from third countries, and the treatment of both domestic and foreign trade and investment in energy in a particular third country. Security of supply should therefore be assessed in the light of the factual circumstances of each case as well as the rights and obligations arising under international law, in particular the international agreements between the Community and the third country concerned. Where appropriate the Commission is encouraged to submit recommendations to negotiate relevant agreements with third countries addressing the security of supply of energy to the Community or to include the necessary issues in other negotiations with those third countries.

(23) Further measures should be taken in order to ensure transparent and non-discriminatory tariffs for access to transport. Those tariffs should be applicable to all users on a non-discriminatory basis. Where a storage facility, linepack or ancillary service operates in a sufficiently competitive market, access could be allowed on the basis of transparent and non-discriminatory market-based mechanisms.

(24) It is necessary to ensure the independence of storage system operators in order to improve third-party access to storage facilities that are technically and/or economically necessary for providing efficient access to the system for the supply of customers. It is therefore appropriate that storage facilities are operated through legally separate entities that have effective decision-making rights with respect to assets necessary to maintain, operate and develop storage facilities. It is also necessary to increase transparency in respect of the storage capacity that is offered to third parties, by obliging Member States to define and publish a non-discriminatory, clear framework that determines the appropriate regulatory regime applicable to storage facilities. That obligation should not require a new decision on access regimes but should improve the transparency regarding the access regime to storage. Confidentiality requirements for commercially sensitive information are particularly important where data of a strategic nature are concerned or where there is only a single user of a storage facility.

(25) Non-discriminatory access to the distribution network determines downstream access to customers at retail level. The scope for discrimination as regards third party access and investment, however, is less significant at distribution level than at transmission level where congestion and the influence of production interests are generally greater than at distribution level. Moreover, legal and functional unbundling of distribution system operators was required, pursuant to Directive 2003/55/EC, only from 1 July

2007 and its effects on the internal market in natural gas still need to be evaluated. The rules on legal and functional unbundling currently in place can lead to effective unbundling provided they are more clearly defined, properly implemented and closely monitored. To create a level playing field at retail level, the activities of distribution system operators should therefore be monitored so that they are prevented from taking advantage of their vertical integration as regards their competitive position on the market, in particular in relation to household and small non-household customers.

(26) Member States should take concrete measures to assist the wider use of biogas and gas from biomass, the producers of which should be granted non-discriminatory access to the gas system, provided that such access is compatible with the relevant technical rules and safety standards on an ongoing basis.

(27) To avoid imposing a disproportionate financial and administrative burden on small distribution system operators, Member States should be able, where necessary, to exempt the undertakings concerned from the legal distribution unbundling requirements.

(28) Where a closed distribution system is used to ensure the optimal efficiency of an integrated energy supply requiring specific operational standards, or a closed distribution system is maintained primarily for the use of the owner of the system, it should be possible to exempt the distribution system operator from obligations which would constitute an unnecessary administrative burden because of the particular nature of the relationship between the distribution system operator and the users of the system. Industrial, commercial or shared services sites such as train station buildings, airports, hospitals, large camping sites with integrated facilities or chemical industry sites can include closed distribution systems because of the specialised nature of their operations.

(29) Directive 2003/55/EC introduced a requirement for Member States to establish regulators with specific competences. However, experience shows that the effectiveness of regulation is frequently hampered through a lack of independence of regulators from government, and insufficient powers and discretion. For that reason, at its meeting on 8 and 9 March 2007, the European Council invited the Commission to develop legislative proposals providing for further harmonisation of the powers and strengthening of the independence of national energy regulators. It should be possible for those national regulatory authorities to cover both the electricity and the gas sectors.

(30) Energy regulators need to be able to take decisions in relation to all relevant regulatory issues if the internal market in natural gas is to function properly, and to be fully independent from any other public or private interests. This precludes neither judicial review nor parliamentary supervision in accordance with the constitutional law of the Member States. In addition, approval of the budget of the regulator by the national legislator does not constitute an obstacle to budgetary autonomy. The provisions relating to autonomy in the implementation of the allocated budget of the regulatory authority should be implemented within the framework defined by national budgetary law and rules. While contributing to the independence of the national regulatory authority from any political or economic interest through an appropriate rotation scheme, it should be possible for Member States to take due account of the availability of human resources and of the size of the board.

(31) In order to ensure effective market access for all market players, including new entrants, non-discriminatory and cost-reflective balancing mechanisms are necessary. This should be achieved through the setting up of transparent market-based mechanisms for the supply and purchase of gas, needed in the framework of balancing requirements. National regulatory authorities should play an active role to ensure that balancing tariffs are non-discriminatory and cost-reflective. At the same time,

appropriate incentives should be provided to balance the in-put and off-take of gas and not to endanger the system.

(32) National regulatory authorities should be able to fix or approve tariffs, or the methodologies underlying the calculation of the tariffs, on the basis of a proposal by the transmission system operator or distribution system operator(s) or liquefied natural gas (LNG) system operator, or on the basis of a proposal agreed between those operator(s) and the users of the network. In carrying out those tasks, national regulatory authorities should ensure that transmission and distribution tariffs are non-discriminatory and cost-reflective, and should take account of the long-term, marginal, avoided network costs from demand-side management measures.

(33) Energy regulators should have the power to issue binding decisions in relation to natural gas undertakings and to impose effective, proportionate and dissuasive penalties on natural gas undertakings which fail to comply with their obligations or to propose that a competent court impose such penalties on them. Energy regulators should also be granted the power to decide, irrespective of the application of competition rules, on appropriate measures ensuring customer benefits through the promotion of effective competition necessary for the proper functioning of the internal market in natural gas. The establishment of gas-release programmes is one of the possible measures that can be used to promote effective competition and ensure the proper functioning of the market. Energy regulators should also be granted the powers to contribute to ensuring high standards of public service in compliance with market opening, to the protection of vulnerable customers, and to the full effectiveness of consumer protection measures. Those provisions should be without prejudice to both the Commission's powers concerning the application of competition rules including the examination of mergers with a Community dimension, and the rules on the internal market such as the free movement of capital. The independent body to which a party affected by the decision of a national regulator has a right to appeal could be a court or other tribunal empowered to conduct a judicial review.

(34) Any harmonisation of the powers of national regulatory authorities should include the powers to provide incentives to natural gas undertakings and to impose effective, proportionate and dissuasive penalties on natural gas undertakings or to propose that a competent court impose such penalties. Moreover, regulatory authorities should have the power to request relevant information from natural gas undertakings, make appropriate and sufficient investigations and settle disputes.

(35) Investments in major new infrastructure should be strongly promoted while ensuring the proper functioning of the internal market in natural gas. In order to enhance the positive effect of exempted infrastructure projects on competition and security of supply, market interest during the project planning phase should be tested and congestion management rules should be implemented. Where an infrastructure is located in the territory of more than one Member State, the Agency for the Cooperation of Energy Regulators established by Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators ([7]) (the 'Agency') should handle as a last resort the exemption request in order to take better account of its cross-border implications and to facilitate its administrative handling. Moreover, given the exceptional risk profile of constructing those exempt major infrastructure projects, it should be possible temporarily to grant partial derogations to undertakings with supply and production interests in respect of the unbundling rules for the projects concerned. The possibility of temporary derogations should apply, for security of supply reasons, in particular, to new pipelines within the Community transporting gas from third countries into the Community. Exemptions granted under Directive 2003/55/EC continue to apply until the scheduled expiry date as decided in the granted exemption decision.

(36) The internal market in natural gas suffers from a lack of liquidity and transparency hindering the efficient allocation of resources, risk hedging and new entry. Trust in the market, its liquidity and the number of market participants needs to increase, and, therefore, regulatory oversight of undertakings active in the supply of gas needs to be increased. Such requirements should be without prejudice to, and compatible with, existing Community law in relation to the financial markets. Energy regulators and financial market regulators need to cooperate in order to enable each other to have an overview of the markets concerned.

(37) Natural gas is mainly, and increasingly, imported into the Community from third countries. Community law should take account of the characteristics of natural gas, such as certain structural rigidities arising from the concentration of suppliers, the long-term contracts or the lack of downstream liquidity. Therefore, more transparency is needed, including in regard to the formation of prices.

(38) Prior to the adoption by the Commission of Guidelines defining further the record-keeping requirements, the Agency and the Committee of European Securities Regulators (the 'CESR'), established by Commission Decision 2009/77/EC ([8]), should confer and advise the Commission in regard to their content. The Agency and the CESR should also cooperate to investigate further and advise on whether transactions in gas supply contracts and gas derivatives should be subject to pre- and/or post-trade transparency requirements and, if so, what the content of those requirements should be.

(39) Member States or, where a Member State has so provided, the regulatory authority, should encourage the development of interruptible supply contracts.

(40) In the interests of security of supply, the balance between supply and demand in individual Member States should be monitored, and such monitoring should be followed by a report on the situation at Community level, taking account of interconnection capacity between areas. Such monitoring should be carried out sufficiently early to enable appropriate measures to be taken if security of supply is compromised. The construction and maintenance of the necessary network infrastructure, including interconnection capacity, should contribute to ensuring a stable gas supply.

(41) Member States should ensure that, taking into account the necessary quality requirements, biogas and gas from biomass or other types of gas are granted non-discriminatory access to the gas system, provided such access is permanently compatible with the relevant technical rules and safety standards. Those rules and standards should ensure that those gases can technically and safely be injected into, and transported through the natural gas system and should also address their chemical characteristics.

(42) Long-term contracts will continue to be an important part of the gas supply of Member States and should be maintained as an option for gas supply undertakings in so far as they do not undermine the objective of this Directive and are compatible with the Treaty, including the competition rules. It is therefore necessary to take into account long-term contracts in the planning of supply and transport capacity of natural gas undertakings.

(43) In order to ensure the maintenance of high standards of public service in the Community, all measures taken by Member States to achieve the objectives of this Directive should be regularly notified to the Commission. The Commission should regularly publish a report analysing measures taken at national level to achieve public service objectives and comparing their effectiveness, with a view to making recommendations as regards measures to be taken at national level to achieve high public service standards. Member States should ensure that when they are connected

to the gas system customers are informed about their rights to be supplied with natural gas of a specified quality at reasonable prices. Measures taken by Member States to protect final customers may differ according to whether they are aimed at household customers or small and medium-sized enterprises.

(44) Respect for the public service requirements is a fundamental requirement of this Directive, and it is important that common minimum standards, respected by all Member States, are specified in this Directive, which take into account the objectives of common protection, security of supply, environmental protection and equivalent levels of competition in all Member States. It is important that the public service requirements can be interpreted on a national basis, taking into account national circumstances and subject to the respect of Community law.

(45) It should be possible for measures implemented by Member States to achieve the objectives of social and economic cohesion to include, in particular, the provision of adequate economic incentives, using, where appropriate, all existing national and Community tools. It should be possible for such tools to include liability mechanisms to guarantee the necessary investment.

(46) To the extent to which measures taken by Member States to fulfil public service obligations constitute State aid under Article 87(1) of the Treaty, there is an obligation under Article 88(3) of the Treaty to notify them to the Commission.

(47) The public service requirements and the common minimum standards that follow from them need to be further strengthened to make sure that all consumers, especially vulnerable ones, can benefit from competition and fair prices. The public service requirements should be defined at national level, taking into account national circumstances; Community law should, however, be respected by the Member States. The citizens of the Union and, where Member States deem it to be appropriate, small enterprises, should be able to enjoy public service obligations, in particular with regard to security of supply and reasonable tariffs. A key aspect in supplying customers is access to objective and transparent consumption data. Thus, consumers should have access to their consumption data and associated prices and services costs so that they can invite competitors to make an offer based on those data. Consumers should also have the right to be properly informed about their energy consumption. Prepayments should reflect the likely consumption of natural gas and different payment systems should be non-discriminatory. Information on energy costs provided to consumers frequently enough will create incentives for energy savings because it will give customers direct feedback on the effects of investment in energy efficiency and change of behaviour.

(48) Consumer interests should be at the heart of this Directive and quality of service should be a central responsibility of natural gas undertakings. Existing rights of consumers need to be strengthened and guaranteed, and should include greater transparency. Consumer protection should ensure that all consumers in the wider remit of the Community benefit from a competitive market. Consumer rights should be enforced by Member States or, where a Member State has so provided, the regulatory authorities.

(49) Clear and comprehensible information should be made available to consumers concerning their rights in relation to the energy sector. The Commission should establish, after consulting relevant stakeholders including Member States, national regulatory authorities, consumer organisations and natural gas undertakings, an accessible, user-friendly energy consumer checklist providing consumers with practical information about their rights. That energy consumer checklist should be provided to all consumers and should be made publicly available.

(50) Energy poverty is a growing problem in the Community. Member States which are affected and which have not yet done so should, therefore, develop national action plans or other appropriate frameworks to tackle energy poverty, aiming at decreasing the number of people suffering such situation. In any event, Member States should ensure the necessary energy supply for vulnerable customers. In doing so, an integrated approach, such as in the framework of social policy, could be used and measures could include social policies or energy efficiency improvements for housing. At the very least, this Directive should allow national policies in favour of vulnerable customers.

(51) Greater consumer protection is guaranteed by the availability of effective means of dispute settlement for all consumers. Member States should introduce speedy and effective complaint handling procedures.

(52) It should be possible to base the introduction of intelligent metering systems on an economic assessment. Should that assessment conclude that the introduction of such metering systems is economically reasonable and cost-effective only for consumers with a certain amount of gas consumption, Member States should be able to take this into account when implementing intelligent metering systems.

(53) Market prices should give the right incentives for the development of the network.

(54) Promoting fair competition and easy access for different suppliers should be of the utmost importance for Member States in order to allow consumers to take full advantage of the opportunities of a liberalised internal market in natural gas.

(55) In order to contribute to security of supply whilst maintaining a spirit of solidarity between Member States, notably in the event of an energy supply crisis, it is important to provide a framework for regional cooperation in a spirit of solidarity. Such cooperation may rely, if Member States so decide, first and foremost on market-based mechanisms. Cooperation for the promotion of regional and bilateral solidarity should not impose a disproportionate burden on or discriminate between market participants.

(56) With a view to creating an internal market in natural gas, Member States should foster the integration of their national markets and the cooperation of system operators at Community and regional level, also incorporating the isolated systems forming gas islands that persist in the Community.

(57) The development of a true internal market in natural gas, through a network connected across the Community, should be one of the main goals of this Directive and regulatory issues on cross border interconnections and regional markets should, therefore, be one of the main tasks of the regulatory authorities, in close cooperation with the Agency where relevant.

(58) Securing common rules for a true internal market and a broad supply of gas should also be one of the main goals of this Directive. To that end, undistorted market prices would provide an incentive for cross-border interconnections while leading, in the long term, to price convergence.

(59) The regulatory authorities should also provide information on the market to permit the Commission to exercise its role of observing and monitoring the internal market in natural gas and its short, medium and long-term evolution, including aspects such as supply and demand, transmission and distribution infrastructure, quality of service, cross-border trade, congestion management, investments, wholesale and consumer prices, market liquidity and environmental and efficiency improvements. National regulatory authorities should report to the competition authorities and the Commission those Member States in which prices impair competition and proper functioning of the market.

(60) Since the objective of this Directive, namely the creation of a fully operational internal market in natural gas, cannot be sufficiently achieved by the Member States and can therefore be better achieved at Community level, the Community may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective.

(61) Under Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks ([9]), the Commission may adopt Guidelines to achieve the necessary degree of harmonisation. Such Guidelines, which constitute binding implementing measures, are, also with regard to certain provisions of this Directive, a useful tool which can be adapted quickly where necessary.

(62) The measures necessary for the implementation of this Directive should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission ([10]).

(63) In particular, the Commission should be empowered to adopt the Guidelines necessary for providing the minimum degree of harmonisation required to achieve the aim of this Directive. Since those measures are of general scope and are designed to amend non-essential elements of this Directive, by supplementing it with new non-essential elements, they must be adopted in accordance with the regulatory procedure with scrutiny provided for in Article 5a of Decision 1999/468/EC.

(64) In accordance with point 34 of the Interinstitutional Agreement on better law-making ([11]), Member States are encouraged to draw up, for themselves and in the interest of the Community, their own tables, illustrating, as far as possible, the correlation between this Directive and the transposition measures, and to make them public.

(65) Given the scope of the amendments made to Directive 2003/55/EC herein, it is desirable, for reasons of clarity and rationalisation, that the provisions in question should be recast by bringing them all together in a single text in a new Directive.

(66) This Directive respects the fundamental rights, and observes the principles, recognised in particular by the Charter of Fundamental Rights of the European Union,

HAVE ADOPTED THIS DIRECTIVE:

*Article 1*

**Subject matter and scope**

1. This Directive establishes common rules for the transmission, distribution, supply and storage of natural gas. It lays down the rules relating to the organisation and functioning of the natural gas sector, access to the market, the criteria and procedures applicable to the granting of authorisations for transmission, distribution, supply and storage of natural gas and the operation of systems.

2. The rules established by this Directive for natural gas, including LNG, shall also apply in a non-discriminatory way to biogas and gas from biomass or other types of gas in so far as such gases can technically and safely be injected into, and transported through, the natural gas system.

*Article 2*

**Definitions**

For the purposes of this Directive, the following definitions apply:

(1) ‘natural gas undertaking’ means a natural or legal person carrying out at least one of the following functions: production, transmission, distribution, supply, purchase or storage of natural gas, including LNG, which is responsible for the commercial, technical and/or maintenance tasks related to those functions, but shall not include final customers;

(2) ‘upstream pipeline network’ means any pipeline or network of pipelines operated and/or constructed as part of an oil or gas production project, or used to convey natural gas from one or more such projects to a processing plant or terminal or final coastal landing terminal;

(3) ‘transmission’ means the transport of natural gas through a network, which mainly contains high-pressure pipelines, other than an upstream pipeline network and other than the part of high-pressure pipelines primarily used in the context of local distribution of natural gas, with a view to its delivery to customers, but not including supply;

(4) ‘transmission system operator’ means a natural or legal person who carries out the function of transmission and is responsible for operating, ensuring the maintenance of, and, if necessary, developing the transmission system in a given area and, where applicable, its interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transport of gas;

(5) ‘distribution’ means the transport of natural gas through local or regional pipeline networks with a view to its delivery to customers, but not including supply;

(6) ‘distribution system operator’ means a natural or legal person who carries out the function of distribution and is responsible for operating, ensuring the maintenance of, and, if necessary, developing the distribution system in a given area and, where applicable, its interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the distribution of gas;

(7) ‘supply’ means the sale, including resale, of natural gas, including LNG, to customers;

(8) ‘supply undertaking’ means any natural or legal person who carries out the function of supply;

(9) ‘storage facility’ means a facility used for the stocking of natural gas and owned and/or operated by a natural gas undertaking, including the part of LNG facilities used for storage but excluding the portion used for production operations, and excluding facilities reserved exclusively for transmission system operators in carrying out their functions;

(10) ‘storage system operator’ means a natural or legal person who carries out the function of storage and is responsible for operating a storage facility;

(11) ‘LNG facility’ means a terminal which is used for the liquefaction of natural gas or the importation, offloading, and re-gasification of LNG, and includes ancillary services and temporary storage necessary for the re-gasification process and subsequent delivery to the transmission system, but does not include any part of LNG terminals used for storage;

(12) ‘LNG system operator’ means a natural or legal person who carries out the function of liquefaction of natural gas, or the importation, offloading, and re-gasification of LNG and is responsible for operating a LNG facility;

(13) ‘system’ means any transmission networks, distribution networks, LNG facilities and/or storage facilities owned and/or operated by a natural gas undertaking, including

linepack and its facilities supplying ancillary services and those of related undertakings necessary for providing access to transmission, distribution and LNG;

(14) ‘ancillary services’ means all services necessary for access to and the operation of transmission networks, distribution networks, LNG facilities, and/or storage facilities, including load balancing, blending and injection of inert gases, but not including facilities reserved exclusively for transmission system operators carrying out their functions;

(15) ‘linepack’ means the storage of gas by compression in gas transmission and distribution systems, but not including facilities reserved for transmission system operators carrying out their functions;

(16) ‘interconnected system’ means a number of systems which are linked with each other;

(17) ‘interconnector’ means a transmission line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States;

(18) ‘direct line’ means a natural gas pipeline complementary to the interconnected system;

(19) ‘integrated natural gas undertaking’ means a vertically or horizontally integrated undertaking;

(20) ‘vertically integrated undertaking’ means a natural gas undertaking or a group of natural gas undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission, distribution, LNG or storage, and at least one of the functions of production or supply of natural gas;

(21) ‘horizontally integrated undertaking’ means an undertaking performing at least one of the functions of production, transmission, distribution, supply or storage of natural gas, and a non-gas activity;

(22) ‘related undertaking’ means an affiliated undertaking, within the meaning of Article 41 of Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 44(2)(g) ([12]) of the Treaty on consolidated accounts ([13]) and/or an associated undertaking, within the meaning of Article 33(1) of that Directive, and/or an undertaking which belong to the same shareholders;

(23) ‘system user’ means a natural or legal person supplying to, or being supplied by, the system;

(24) ‘customer’ means a wholesale or final customer of natural gas or a natural gas undertaking which purchases natural gas;

(25) ‘household customer’ means a customer purchasing natural gas for his own household consumption;

(26) ‘non-household customer’ means a customer purchasing natural gas which is not for his own household use;

(27) ‘final customer’ means a customer purchasing natural gas for his own use;

(28) ‘eligible customer’ means a customer who is free to purchase gas from the supplier of his choice, within the meaning of Article 37;

(29) ‘wholesale customer’ means a natural or legal person other than a transmission system operator or distribution system operator who purchases natural gas for the purpose of resale inside or outside the system where he is established;

(30) ‘long-term planning’ means the planning of supply and transport capacity of natural gas undertakings on a long-term basis with a view to meeting the demand for natural gas of the system, diversification of sources and securing supplies to customers;

(31) ‘emergent market’ means a Member State in which the first commercial supply of its first long-term natural gas supply contract was made not more than 10 years earlier;

(32) ‘security’ means both security of supply of natural gas and technical safety;

(33) ‘new infrastructure’ means an infrastructure not completed by 4 August 2003;

(34) ‘gas supply contract’ means a contract for the supply of natural gas, but does not include a gas derivative;

(35) ‘gas derivative’ means a financial instrument specified in points 5, 6 or 7 of Section C of Annex I to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments ([14]), where that instrument relates to natural gas;

(36) ‘control’ means any rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by:

(a) ownership or the right to use all or part of the assets of an undertaking;

(b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking.

*Article 9*

**Unbundling of transmission systems and transmission system operators**

1. Member States shall ensure that from 3 March 2012:

(a) each undertaking which owns a transmission system acts as a transmission system operator;

(b) the same person or persons are entitled neither:

(i) directly or indirectly to exercise control over an undertaking performing any of the functions of production or supply, and directly or indirectly to exercise control or exercise any right over a transmission system operator or over a transmission system; nor

(ii) directly or indirectly to exercise control over a transmission system operator or over a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of production or supply;

(c) the same person or persons are not entitled to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking, of a transmission system operator or a transmission system, and directly or indirectly to exercise control or exercise any right over an undertaking performing any of the functions of production or supply; and

(d) the same person is not entitled to be a member of the supervisory board, the administrative board or bodies legally representing the undertaking, of both an undertaking performing any of the functions of production or supply and a transmission system operator or a transmission system.

2. The rights referred to in points (b) and (c) of paragraph 1 shall include, in particular:

(a) the power to exercise voting rights;

(b) the power to appoint members of the supervisory board, the administrative board or bodies legally representing the undertaking; or

(c) the holding of a majority share.

3. For the purpose of paragraph 1(b), the notion 'undertaking performing any of the functions of production or supply' shall include 'undertaking performing any of the functions of generation and supply' within the meaning of Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity ([17]), and the terms 'transmission system operator' and 'transmission system' shall include 'transmission system operator' and 'transmission system' within the meaning of that Directive.

4. Member States may allow for derogations from points (b) and (c) of paragraphs 1 until 3 March 2013, provided that transmission system operators are not part of a vertically integrated undertaking.

5. The obligation set out in paragraph 1(a) of this Article shall be deemed to be fulfilled in a situation where two or more undertakings which own transmission systems have created a joint venture which acts as a transmission system operator in two or more Member States for the transmission systems concerned. No other undertaking may be part of the joint venture, unless it has been approved under Article 14 as an independent system operator or as an independent transmission operator for the purposes of Chapter IV.

6. For the implementation of this Article, where the person referred to in points (b), (c) and (d) of paragraph 1 is the Member State or another public body, two separate public bodies exercising control over a transmission system operator or over a transmission system on the one hand, and over an undertaking performing any of the functions of production or supply on the other, shall be deemed not to be the same person or persons.

7. Member States shall ensure that neither commercially sensitive information referred to in Article 16 held by a transmission system operator which was part of a vertically integrated undertaking, nor the staff of such a transmission system operator, is transferred to undertakings performing any of the functions of production and supply.

8. Where on 3 September 2009, the transmission system belongs to a vertically integrated undertaking a Member State may decide not to apply paragraph 1.

In such case, the Member State concerned shall either:

(a) designate an independent system operator in accordance with Article 14, or

(b) comply with the provisions of Chapter IV.

9. Where, on 3 September 2009, the transmission system belongs to a vertically integrated undertaking and there are arrangements in place which guarantee more effective independence of the transmission system operator than the provisions of Chapter IV, a Member State may decide not to apply paragraph 1.

10. Before an undertaking is approved and designated as a transmission system operator under paragraph 9 of this Article, it shall be certified according to the procedures laid down in Article 10(4), (5) and (6) of this Directive and in Article 3 of Regulation (EC) No 715/2009, pursuant to which the Commission shall verify that the arrangements in place clearly guarantee more effective independence of the transmission system operator than the provisions of Chapter IV.

11. Vertically integrated undertakings which own a transmission system shall not in any event be prevented from taking steps to comply with paragraph 1.

12. Undertakings performing any of the functions of production or supply shall not in any event be able to directly or indirectly take control over or exercise any right over unbundled transmission system operators in Member States which apply paragraph 1.

*Article 10*

**Designation and certification of transmission system operators**

1. Before an undertaking is approved and designated as transmission system operator, it shall be certified according to the procedures laid down in paragraphs 4, 5 and 6 of this Article and in Article 3 of Regulation (EC) No 715/2009.

2. Undertakings which own a transmission system and which have been certified by the national regulatory authority as having complied with the requirements of Article 9, pursuant to the certification procedure, shall be approved and designated as transmission system operators by Member States. The designation of transmission system operators shall be notified to the Commission and published in the *Official Journal of the European Union*.

3. Transmission system operators shall notify to the regulatory authority any planned transaction which may require a reassessment of their compliance with the requirements of Article 9.

4. The regulatory authorities shall monitor the continuing compliance of transmission system operators with the requirements of Article 9. They shall open a certification procedure to ensure such compliance:

(a) upon notification by the transmission system operator pursuant to paragraph 3;

(b) on their own initiative where they have knowledge that a planned change in rights or influence over transmission system owners or transmission system operators may lead to an infringement of Article 9, or where they have reason to believe that such an infringement may have occurred; or

(c) upon a reasoned request from the Commission.

5. The regulatory authorities shall adopt a decision on the certification of a transmission system operator within a period of four months from the date of the notification by the transmission system operator or from the date of the Commission request. After expiry of that period, the certification shall be deemed to be granted. The explicit or tacit decision of the regulatory authority shall become effective only after the conclusion of the procedure set out in paragraph 6.

6. The explicit or tacit decision on the certification of a transmission system operator shall be notified without delay to the Commission by the regulatory authority, together with all the relevant information with respect to that decision. The Commission shall act in accordance with the procedure laid down in Article 3 of Regulation (EC) No 715/2009.

7. The regulatory authorities and the Commission may request from transmission system operators and undertakings performing any of the functions of production or supply any information relevant for the fulfilment of their tasks under this Article.

8. The regulatory authorities and the Commission shall preserve the confidentiality of commercially sensitive information.

*Article 11*

**Certification in relation to third countries**

1. Where certification is requested by a transmission system owner or a transmission system operator which is controlled by a person or persons from a third country or third countries, the regulatory authority shall notify the Commission.

The regulatory authority shall also notify to the Commission without delay any circumstances that would result in a person or persons from a third country or third countries acquiring control of a transmission system or a transmission system operator.

2. The transmission system operator shall notify to the regulatory authority any circumstances that would result in a person or persons from a third country or third countries acquiring control of the transmission system or the transmission system operator.

3. The regulatory authority shall adopt a draft decision on the certification of a transmission system operator within four months from the date of notification by the transmission system operator. It shall refuse the certification if it has not been demonstrated:

(a) that the entity concerned complies with the requirements of Article 9; and

(b) to the regulatory authority or to another competent authority designated by the Member State that granting certification will not put at risk the security of energy supply of the Member State and the Community. In considering that question the regulatory authority or other competent authority so designated shall take into account:

(i) the rights and obligations of the Community with respect to that third country arising under international law, including any agreement concluded with one or more third countries to which the Community is a party and which addresses the issues of security of energy supply;

(ii) the rights and obligations of the Member State with respect to that third country arising under agreements concluded with it, insofar as they are in compliance with Community law; and

(iii) other specific facts and circumstances of the case and the third country concerned.

4. The regulatory authority shall notify the decision to the Commission without delay, together with all the relevant information with respect to that decision.

5. Member States shall provide for the regulatory authority or the designated competent authority referred to in paragraph 3(b), before the regulatory authority adopts a decision on the certification, to request an opinion from the Commission on whether:

(a) the entity concerned complies with the requirements of Article 9; and

(b) granting certification will not put at risk the security of energy supply to the Community.

6. The Commission shall examine the request referred to in paragraph 5 as soon as it is received. Within a period of two months after receiving the request, it shall deliver its opinion to the national regulatory authority or, if the request was made by the designated competent authority, to that authority.

In preparing the opinion, the Commission may request the views of the Agency, the Member State concerned, and interested parties. In the event that the Commission makes such a request, the two-month period shall be extended by two months.

In the absence of an opinion by the Commission within the period referred to in the first and second subparagraphs, the Commission is deemed not to raise objections to the decision of the regulatory authority.

7. When assessing whether the control by a person or persons from a third country or third countries will put at risk the security of energy supply to the Community, the Commission shall take into account:

(a) the specific facts of the case and the third country or third countries concerned; and

(b) the rights and obligations of the Community with respect to that third country or third countries arising under international law, including an agreement concluded with one or more third countries to which the Community is a party and which addresses the issues of security of supply.

8. The national regulatory authority shall, within a period of two months after the expiry of the period referred to in paragraph 6, adopt its final decision on the certification. In adopting its final decision the

national regulatory authority shall take utmost account of the Commission's opinion. In any event Member States shall have the right to refuse certification where granting certification puts at risk the Member State's security of energy supply or the security of energy supply of another Member State. Where the Member State has designated another competent authority to assess paragraph 3(b), it may require the national regulatory authority to adopt its final decision in accordance with the assessment of that competent authority. The regulatory authority's final decision and the Commission's opinion shall be published together. Where the final decision diverges from the Commission's opinion, the Member State concerned shall provide and publish, together with that decision, the reasoning underlying such decision.

9. Nothing in this Article shall affect the right of Member States to exercise, in compliance with Community law, national legal controls to protect legitimate public security interests.

10. The Commission may adopt Guidelines setting out the details of the procedure to be followed for the application of this Article. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 51(3).

11. This Article, with exception of paragraph 3(a), shall also apply to Member States which are subject to a derogation under Article 49.

*Article 14*

**Independent system operators**

1. Where the transmission system belongs to a vertically integrated undertaking on 3 September 2009, Member States may decide not to apply Article 9(1) and designate an independent system operator upon a proposal from the transmission system owner. Such designation shall be subject to approval by the Commission.

2. The Member State may approve and designate an independent system operator only where:

(a) the candidate operator has demonstrated that it complies with the requirements of Article 9(1)(b), (c) and (d);

(b) the candidate operator has demonstrated that it has at its disposal the required financial, technical, physical and human resources to carry out its tasks under Article 13;

(c) the candidate operator has undertaken to comply with a ten-year network development plan monitored by the regulatory authority;

(d) the transmission system owner has demonstrated its ability to comply with its obligations under paragraph 5. To that end, it shall provide all the draft contractual arrangements with the candidate undertaking and any other relevant entity; and

(e) the candidate operator has demonstrated its ability to comply with its obligations under Regulation (EC) No 715/2009 including the cooperation of transmission system operators at European and regional level.

3. Undertakings which have been certified by the regulatory authority as having complied with the requirements of Article 11 and of paragraph 2 of this Article shall be approved and designated as independent system operators by Member States. The certification procedure in either Article 10 of this Directive and Article 3 of Regulation (EC) No 715/2009 or in Article 11 of this Directive shall be applicable.

4. Each independent system operator shall be responsible for granting and managing third-party access, including the collection of access charges and congestion charges, for operating, maintaining and developing the transmission system, as well as for ensuring the long-term ability of the system to meet reasonable demand through investment planning. When developing the transmission system the independent system operator shall be responsible for planning (including authorisation procedure), construction and commissioning of the new infrastructure. For this purpose, the independent system operator shall act as a transmission system operator in accordance with this Chapter. The transmission

system owner shall not be responsible for granting and managing third-party access, nor for investment planning.

5. Where an independent system operator has been designated, the transmission system owner shall:

(a) provide all the relevant cooperation and support to the independent system operator for the fulfilment of its tasks, including in particular all relevant information;

(b) finance the investments decided by the independent system operator and approved by the regulatory authority, or give its agreement to financing by any interested party including the independent system operator. The relevant financing arrangements shall be subject to approval by the regulatory authority. Prior to such approval, the regulatory authority shall consult the transmission system owner together with other interested parties;

(c) provide for the coverage of liability relating to the network assets, excluding the liability relating to the tasks of the independent system operator; and

(d) provide guarantees to facilitate financing any network expansions with the exception of those investments where, pursuant to point (b), it has given its agreement to financing by any interested party including the independent system operator.

6. In close cooperation with the regulatory authority, the relevant national competition authority shall be granted all relevant powers to effectively monitor compliance of the transmission system owner with its obligations under paragraph 5.

*Article 15*

**Unbundling of transmission system owners and storage system operators**

1. A transmission system owner, where an independent system operator has been appointed, and a storage system operator which are part of vertically integrated undertakings shall be independent at least in terms of their legal form, organisation and decision making from other activities not relating to transmission, distribution and storage.

This Article shall apply only to storage facilities that are technically and/or economically necessary for providing efficient access to the system for the supply of customers pursuant to Article 33.

2. In order to ensure the independence of the transmission system owner and storage system operator referred to in paragraph 1, the following minimum criteria shall apply:

(a) persons responsible for the management of the transmission system owner and storage system operator shall not participate in company structures of the integrated natural gas undertaking responsible, directly or indirectly, for the day-to-day operation of the production and supply of natural gas;

(b) appropriate measures shall be taken to ensure that the professional interests of persons responsible for the management of the transmission system owner and storage system operator are taken into account in a manner that ensures that they are capable of acting independently;

(c) the storage system operator shall have effective decision-making rights, independent from the integrated natural gas undertaking, with respect to assets necessary to operate, maintain or develop the storage facilities. This shall not preclude the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect of return on assets regulated indirectly in accordance with Article 41(6) in a subsidiary are protected. In particular, this shall enable the parent company to approve the annual financial plan, or any equivalent instrument, of the storage system operator and to set global limits on the levels of indebtedness of its subsidiary. It shall not permit the parent company to give instructions regarding day-to-day operations, nor with respect to individual decisions

concerning the construction or upgrading of storage facilities, that do not exceed the terms of the approved financial plan, or any equivalent instrument; and

(d) the transmission system owner and the storage system operator shall establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded and ensure that observance of it is adequately monitored. The compliance programme shall set out the specific obligations of employees to meet those objectives. An annual report, setting out the measures taken, shall be submitted by the person or body responsible for monitoring the compliance programme to the regulatory authority and shall be published.

3. The Commission may adopt Guidelines to ensure full and effective compliance of the transmission system owner and of the storage system operator with paragraph 2 of this Article. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 51(3).

*Article 16*

**Confidentiality for transmission system operators and transmission system owners**

1. Without prejudice to Article 30 or any other legal duty to disclose information, each transmission, storage and/or LNG system operator, and each transmission system owner, shall preserve the confidentiality of commercially sensitive information obtained in the course of carrying out its activities, and shall prevent information about its own activities which may be commercially advantageous from being disclosed in a discriminatory manner. In particular, it shall not disclose any commercially sensitive information to the remaining parts of the undertaking, unless this is necessary for carrying out a business transaction. In order to ensure the full respect of the rules on information unbundling, Member States shall ensure that the transmission system owner including, in the case of a combined operator, the distribution system operator, and the remaining part of the undertaking do not use joint services, such as joint legal services, apart from purely administrative or IT functions.

2. Transmission, storage and/or LNG system operators shall not, in the context of sales or purchases of natural gas by related undertakings, misuse commercially sensitive information obtained from third parties in the context of providing or negotiating access to the system.

3. Information necessary for effective competition and the efficient functioning of the market shall be made public. That obligation shall be without prejudice to protecting commercially sensitive information.

*Article 17*

**Assets, equipment, staff and identity**

1. Transmission system operators shall be equipped with all human, technical, physical and financial resources necessary for fulfilling their obligations under this Directive and carrying out the activity of gas transmission, in particular:

(a) assets that are necessary for the activity of gas transmission, including the transmission system, shall be owned by the transmission system operator;

(b) personnel necessary for the activity of gas transmission, including the performance of all corporate tasks, shall be employed by the transmission system operator;

(c) leasing of personnel and rendering of services, to and from any other parts of the vertically integrated undertaking shall be prohibited. A transmission system operator may, however, render services to the vertically integrated undertaking as long as:

(i) the provision of those services does not discriminate between system users, is available to all system users on the same terms and conditions and does not restrict, distort or prevent competition in production or supply; and

(ii) the terms and conditions of the provision of those services are approved by the regulatory authority;

(d) without prejudice to the decisions of the Supervisory Body under Article 20, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate request from the transmission system operator.

2. The activity of gas transmission shall include at least the following tasks in addition to those listed in Article 13:

(a) the representation of the transmission system operator and contacts to third parties and the regulatory authorities;

(b) the representation of the transmission system operator within the European Network of Transmission System Operators for Gas (ENTSO for Gas);

(c) granting and managing third-party access on a non-discriminatory basis between system users or classes of system users;

(d) the collection of all the transmission system related charges including access charges, balancing charges for ancillary services such as gas treatment, purchasing of services (balancing costs, energy for losses);

(e) the operation, maintenance and development of a secure, efficient and economic transmission system;

(f) investment planning ensuring the long-term ability of the system to meet reasonable demand and guaranteeing security of supply;

(g) the setting up of appropriate joint ventures, including with one or more transmission system operators, gas exchanges, and the other relevant actors pursuing the objective to develop the creation of regional markets or to facilitate the liberalisation process; and

(h) all corporate services, including legal services, accountancy and IT services.

3. Transmission system operators shall be organised in a legal form as referred to in Article 1 of Council Directive 68/151/EEC ([18]).

4. The transmission system operator shall not, in its corporate identity, communication, branding and premises, create confusion in respect of the separate identity of the vertically integrated undertaking or any part thereof.

5. The transmission system operator shall not share IT systems or equipment, physical premises and security access systems with any part of the vertically integrated undertaking, nor use the same consultants or external contractors for IT systems or equipment, and security access systems.

6. The accounts of transmission system operators shall be audited by an auditor other than the one auditing the vertically integrated undertaking or any part thereof.

*Article 18*

**Independence of the transmission system operator**

1. Without prejudice to the decisions of the Supervisory Body under Article 20, the transmission system operator shall have:

(a) effective decision-making rights, independent from the vertically integrated undertaking, with respect to assets necessary to operate, maintain or develop the transmission system; and

(b) the power to raise money on the capital market in particular through borrowing and capital increase.

2. The transmission system operator shall at all times act so as to ensure it has the resources it needs in order to carry out the activity of transmission properly and efficiently and develop and maintain an efficient, secure and economic transmission system.

3. Subsidiaries of the vertically integrated undertaking performing functions of production or supply shall not have any direct or indirect shareholding in the transmission system operator. The transmission system operator shall neither have any direct or indirect shareholding in any subsidiary of the vertically integrated undertaking performing functions of production or supply, nor receive dividends or any other financial benefit from that subsidiary.

4. The overall management structure and the corporate statutes of the transmission system operator shall ensure effective independence of the transmission system operator in compliance with this Chapter. The vertically integrated undertaking shall not determine, directly or indirectly, the competitive behaviour of the transmission system operator in relation to the day to day activities of the transmission system operator and management of the network, or in relation to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.

5. In fulfilling their tasks in Article 13 and Article 17(2) of this Directive, and in complying with Article 13(1), Article 14(1)(a), Article 16(2), (3) and (5), Article 18(6) and Article 21(1) of Regulation (EC) No 715/2009, transmission system operators shall not discriminate against different persons or entities and shall not restrict, distort or prevent competition in production or supply.

6. Any commercial and financial relations between the vertically integrated undertaking and the transmission system operator, including loans from the transmission system operator to the vertically integrated undertaking, shall comply with market conditions. The transmission system operator shall keep detailed records of such commercial and financial relations and make them available to the regulatory authority upon request.

7. The transmission system operator shall submit for approval by the regulatory authority all commercial and financial agreements with the vertically integrated undertaking.

8. The transmission system operator shall inform the regulatory authority of the financial resources, referred to in Article 17(1)(d), available for future investment projects and/or for the replacement of existing assets.

9. The vertically integrated undertaking shall refrain from any action impeding or prejudicing the transmission system operator from complying with its obligations in this Chapter and shall not require the transmission system operator to seek permission from the vertically integrated undertaking in fulfilling those obligations.

10. An undertaking which has been certified by the regulatory authority as being in compliance with the requirements of this Chapter shall be approved and designated as a transmission system operator by the Member State concerned. The certification procedure in either Article 10 of this Directive and Article 3 of Regulation (EC) No 715/2009 or in Article 11 of this Directive shall apply.

*Article 19*

**Independence of the staff and the management of the transmission system operator**

1. Decisions regarding the appointment and renewal, working conditions including remuneration, and termination of the term of office, of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator shall be taken by the Supervisory Body of the transmission system operator appointed in accordance with Article 20.

2. The identity of, and the conditions governing the term, the duration and the termination of office of, the persons nominated by the Supervisory Body for appointment or renewal as persons responsible for the executive management and/or as members of the administrative bodies of the transmission system operator, and the reasons for any proposed decision terminating such term of office, shall be notified to the regulatory authority. Those conditions and the decisions referred to in paragraph 1 shall become binding only if the regulatory authority has raised no objections within three weeks of notification.

The regulatory authority may object to the decisions referred to in paragraph 1 where:

(a) doubts arise as to the professional independence of a nominated person responsible for the management and/or member of the administrative bodies; or

(b) in the case of premature termination of a term of office, doubts exist regarding the justification of such premature termination.

3. No professional position or responsibility, interest or business relationship, directly or indirectly, with the vertically integrated undertaking or any part of it or its controlling shareholders other than the transmission system operator shall be exercised for a period of three years before the appointment of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are subject to this paragraph.

4. The persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall have no other professional position or responsibility, interest or business relationship, directly or indirectly, with any other part of the vertically integrated undertaking or with its controlling shareholders.

5. The persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall hold no interest in or receive any financial benefit, directly or indirectly, from any part of the vertically integrated undertaking other than the transmission system operator. Their remuneration shall not depend on activities or results of the vertically integrated undertaking other than those of the transmission system operator.

6. Effective rights of appeal to the regulatory authority shall be guaranteed for any complaints by the persons responsible for the management and/or members of the administrative bodies of the transmission system operator against premature terminations of their term of office.

7. After termination of their term of office in the transmission system operator, the persons responsible for its management and/or members of its administrative bodies shall have no professional position or responsibility, interest or business relationship with any part of the vertically integrated undertaking other than the transmission system operator, or with its controlling shareholders for a period of not less than four years.

8. Paragraph 3 shall apply to the majority of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator.

The persons responsible for the management and/or members of the administrative bodies of the transmission system operator who are not subject to paragraph 3 shall have exercised no management or other relevant activity in the vertically integrated undertaking for a period of at least six months before their appointment.

The first subparagraph of this paragraph and paragraphs 4 to 7 shall be applicable to all the persons belonging to the executive management and to those directly reporting to them on matters related to the operation, maintenance or development of the network.

*Article 20*

**Supervisory Body**

1. The transmission system operator shall have a Supervisory Body which shall be in charge of taking decisions which may have a significant impact on the value of the assets of the shareholders within the transmission system operator, in particular decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of the transmission system operator and the amount of dividends distributed to shareholders. The decisions falling under the remit of the Supervisory Body shall exclude

those that are related to the day to day activities of the transmission system operator and management of the network, and in relation to activities necessary for the preparation of the ten-year network development plan developed pursuant to Article 22.

2. The Supervisory Body shall be composed of members representing the vertically integrated undertaking, members representing third party shareholders and, where the relevant legislation of a Member State so provides, members representing other interested parties such as employees of the transmission system operator.

3. The first subparagraph of Article 19(2) and Article 19(3) to (7) shall apply to at least half of the members of the Supervisory Body minus one.

Point (b) of the second subparagraph of Article 19(2) shall apply to all the members of the Supervisory Body.

*Article 21*

**Compliance programme and compliance officer**

1. Member States shall ensure that transmission system operators establish and implement a compliance programme which sets out the measures taken in order to ensure that discriminatory conduct is excluded and ensure that the compliance with that programme is adequately monitored. The compliance programme shall set out the specific obligations of employees to meet those objectives. It shall be subject to approval by the regulatory authority. Without prejudice to the powers of the national regulator, compliance with the program shall be independently monitored by a compliance officer.

2. The compliance officer shall be appointed by the Supervisory Body, subject to the approval by the regulatory authority. The regulatory authority may refuse the approval of the compliance officer only for reasons of lack of independence or professional capacity. The compliance officer may be a natural or legal person. Article 19(2) to (8) shall apply to the compliance officer.

3. The compliance officer shall be in charge of:

(a) monitoring the implementation of the compliance programme;

(b) elaborating an annual report, setting out the measures taken in order to implement the compliance programme and submitting it to the regulatory authority;

(c) reporting to the Supervisory Body and issuing recommendations on the compliance programme and its implementation;

(d) notifying the regulatory authority on any substantial breaches with regard to the implementation of the compliance programme; and

(e) reporting to the regulatory authority on any commercial and financial relations between the vertically integrated undertaking and the transmission system operator.

4. The compliance officer shall submit the proposed decisions on the investment plan or on individual investments in the network to the regulatory authority. This shall occur at the latest when the management and/or the competent administrative body of the transmission system operator submits them to the Supervisory Body.

5. Where the vertically integrated undertaking, in the general assembly or through the vote of the members of the Supervisory Body it has appointed, has prevented the adoption of a decision with the effect of preventing or delaying investments, which under the ten-year network development plan, was to be executed in the following three years, the compliance officer shall report this to the regulatory authority, which then shall act in accordance with Article 22.

6. The conditions governing the mandate or the employment conditions of the compliance officer, including the duration of his mandate, shall be subject to approval by the regulatory authority. Those conditions shall ensure the independence of the compliance officer, including by providing it with all the resources necessary for fulfilling his duties. During his mandate, the compliance officer shall have no other

professional position, responsibility or interest, directly or indirectly, in or with any part of the vertically integrated undertaking or with its controlling shareholders.

7. The compliance officer shall report regularly, either orally or in writing, to the regulatory authority and shall have the right to report regularly, either orally or in writing, to the Supervisory Body of the transmission system operator.

8. The compliance officer may attend all meetings of the management or administrative bodies of the transmission system operator, and those of the Supervisory Body and the general assembly. The compliance officer shall attend all meetings that address the following matters:

(a) conditions for access to the network, as defined in Regulation (EC) No 715/2009, in particular regarding tariffs, third party access services, capacity allocation and congestion management, transparency, balancing and secondary markets;

(b) projects undertaken in order to operate, maintain and develop the transmission system, including investments in new transport connections, in expansion of capacity and in optimisation of existing capacity;

(c) energy purchases or sales necessary for the operation of the transmission system.

9. The compliance officer shall monitor the compliance of the transmission system operator with Article 16.

10. The compliance officer shall have access to all relevant data and to the offices of the transmission system operator and to all the information necessary for the fulfilment of his task.

11. After prior approval by the regulatory authority, the Supervisory Body may dismiss the compliance officer. It shall dismiss the compliance officer for reasons of lack of independence or professional capacity upon request of the regulatory authority.

12. The compliance officer shall have access to the offices of the transmission system operator without prior announcement.

*Article 22*

**Network development and powers to make investment decisions**

1. Every year, transmission system operators shall submit to the regulatory authority a ten-year network development plan based on existing and forecast supply and demand after having consulted all the relevant stakeholders. That network development plan shall contain efficient measures in order to guarantee the adequacy of the system and the security of supply.

2. The ten-year network development plan shall, in particular:

(a) indicate to market participants the main transmission infrastructure that needs to be built or upgraded over the next ten years;

(b) contain all the investments already decided and identify new investments which have to be executed in the next three years; and

(c) provide for a time frame for all investment projects.

3. When elaborating the ten-year network development plan, the transmission system operator shall make reasonable assumptions about the evolution of the production, supply, consumption and exchanges with other countries, taking into account investment plans for regional and Community-wide networks, as well as investment plans for storage and LNG regasification facilities.

4. The regulatory authority shall consult all actual or potential system users on the ten-year network development plan in an open and transparent manner. Persons or undertakings claiming to be potential system users may be required to substantiate such claims. The regulatory authority shall publish the result of the consultation process, in particular possible needs for investments.

5. The regulatory authority shall examine whether the ten-year network development plan covers all investment needs identified during the consultation process, and whether it is consistent with the non-binding Community-wide ten-year network development plan (Community-wide network development plan) referred to in Article 8(3)(b) of Regulation (EC) No 715/2009. If any doubt arises as to the consistency with the Community-wide network development plan, the regulatory authority shall consult the Agency. The regulatory authority may require the transmission system operator to amend its ten-year network development plan.

6. The regulatory authority shall monitor and evaluate the implementation of the ten-year network development plan.

7. In circumstances where the transmission system operator, other than for overriding reasons beyond its control, does not execute an investment, which, under the ten-year network development plan, was to be executed in the following three years, Member States shall ensure that the regulatory authority is required to take at least one of the following measures to ensure that the investment in question is made if such investment is still relevant on the basis of the most recent ten-year network development plan:

(a) to require the transmission system operator to execute the investments in question;

(b) to organise a tender procedure open to any investors for the investment in question; or

(c) to oblige the transmission system operator to accept a capital increase to finance the necessary investments and allow independent investors to participate in the capital.

Where the regulatory authority has made use of its powers under point (b) of the first subparagraph, it may oblige the transmission system operator to agree to one or more of the following:

(a) financing by any third party;

(b) construction by any third party;

(c) building the new assets concerned itself;

(d) operating the new asset concerned itself.

The transmission system operator shall provide the investors with all information needed to realise the investment, shall connect new assets to the transmission network and shall generally make its best efforts to facilitate the implementation of the investment project.

The relevant financial arrangements shall be subject to approval by the regulatory authority.

8. Where the regulatory authority has made use of its powers under the first subparagraph of paragraph 7, the relevant tariff regulations shall cover the costs of the investments in question.

*Article 32*

**Third-party access**

1. Member States shall ensure the implementation of a system of third party access to the transmission and distribution system, and LNG facilities based on published tariffs, applicable to all eligible customers, including supply undertakings, and applied objectively and without discrimination between system users. Member States shall ensure that those tariffs, or the methodologies underlying their calculation are approved prior to their entry into force in accordance with Article 41 by a regulatory authority referred to in Article 39(1) and that those tariffs — and the methodologies, where only methodologies are approved — are published prior to their entry into force.

2. Transmission system operators shall, if necessary for the purpose of carrying out their functions including in relation to cross-border transmission, have access to the network of other transmission system operators.

3. The provisions of this Directive shall not prevent the conclusion of long-term contracts in so far as they comply with Community competition rules

*Article 34*

**Access to upstream pipeline networks**

1. Member States shall take the necessary measures to ensure that natural gas undertakings and eligible customers, wherever they are located, are able to obtain access to upstream pipeline networks, including facilities supplying technical services incidental to such access, in accordance with this Article, except for the parts of such networks and facilities which are used for local production operations at the site of a field where the gas is produced. The measures shall be notified to the Commission in accordance with the provisions of Article 54.

2. The access referred to in paragraph 1 shall be provided in a manner determined by the Member State in accordance with the relevant legal instruments. Member States shall apply the objectives of fair and open access, achieving a competitive market in natural gas and avoiding any abuse of a dominant position, taking into account security and regularity of supplies, capacity which is or can reasonably be made available, and environmental protection. The following matters may be taken into account:

(a) the need to refuse access where there is an incompatibility of technical specifications which cannot reasonably be overcome;

(b) the need to avoid difficulties which cannot reasonably be overcome and could prejudice the efficient, current and planned future production of hydrocarbons, including that from fields of marginal economic viability;

(c) the need to respect the duly substantiated reasonable needs of the owner or operator of the upstream pipeline network for the transport and processing of gas and the interests of all other users of the upstream pipeline network or relevant processing or handling facilities who may be affected; and

(d) the need to apply their laws and administrative procedures, in conformity with Community law, for the grant of authorisation for production or upstream development.

3. Member States shall ensure that they have in place dispute-settlement arrangements, including an authority independent of the parties with access to all relevant information, to enable disputes relating to access to upstream pipeline networks to be settled expeditiously, taking into account the criteria in paragraph 2 and the number of parties which may be involved in negotiating access to such networks.

4. In the event of cross-border disputes, the dispute-settlement arrangements for the Member State having jurisdiction over the upstream pipeline network which refuses access shall be applied. Where, in cross-border disputes, more than one Member State covers the network concerned, the Member States concerned shall consult each other with a view to ensuring that the provisions of this Directive are applied consistently.

*Article 36*

**New infrastructure**

1. Major new gas infrastructure, i.e. interconnectors, LNG and storage facilities, may, upon request, be exempted, for a defined period of time, from the provisions of Articles 9, 32, 33 and 34 and Article 41(6), (8) and (10) under the following conditions:

(a) the investment must enhance competition in gas supply and enhance security of supply;

(b) the level of risk attached to the investment must be such that the investment would not take place unless an exemption was granted;

(c) the infrastructure must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that infrastructure will be built;

(d) charges must be levied on users of that infrastructure; and

(e) the exemption must not be detrimental to competition or the effective functioning of the internal market in natural gas, or the efficient functioning of the regulated system to which the infrastructure is connected.

2. Paragraph 1 shall also apply to significant increases of capacity in existing infrastructure and to modifications of such infrastructure which enable the development of new sources of gas supply.

3. The regulatory authority referred to in Chapter VIII may, on a case-by-case basis, decide on the exemption referred to in paragraphs 1 and 2.

4. Where the infrastructure in question is located in the territory of more than one Member State, the Agency may submit an advisory opinion to the regulatory authorities of the Member States concerned, which may be used as a basis for their decision, within two months from the date on which the request for exemption was received by the last of those regulatory authorities.

Where all the regulatory authorities concerned agree on the request for exemption within six months of the date on which it was received by the last of the regulatory authorities, they shall inform the Agency of their decision.

The Agency shall exercise the tasks conferred on the regulatory authorities of the Member States concerned by the present Article:

(a) where all regulatory authorities concerned have not been able to reach an agreement within a period of six months from the date on which the request for exemption was received by the last of those regulatory authorities; or

(b) upon a joint request from the regulatory authorities concerned.

All regulatory authorities concerned may, jointly, request that the period referred to in point (a) of the third subparagraph is extended by up to three months.

5. Before taking a decision, the Agency shall consult the relevant regulatory authorities and the applicants.

6. An exemption may cover all or part of the capacity of the new infrastructure, or of the existing infrastructure with significantly increased capacity.

In deciding to grant an exemption, consideration shall be given, on a case-by-case basis, to the need to impose conditions regarding the duration of the exemption and non-discriminatory access to the infrastructure. When deciding on those conditions, account shall, in particular, be taken of the additional capacity to be built or the modification of existing capacity, the time horizon of the project and national circumstances.

Before granting an exemption, the regulatory authority shall decide upon the rules and mechanisms for management and allocation of capacity. The rules shall require that all potential users of the infrastructure are invited to indicate their interest in contracting capacity before capacity allocation in the new infrastructure, including for own use, takes place. The regulatory authority shall require congestion management rules to include the obligation to offer unused capacity on the market and shall require users of the infrastructure to be entitled to trade their contracted capacities on the secondary market. In its assessment of the criteria referred to in points (a), (b) and (e) of paragraph 1, the regulatory authority shall take into account the results of that capacity allocation procedure.

The exemption decision, including any conditions referred to in the second subparagraph of this paragraph, shall be duly reasoned and published.

7. Notwithstanding paragraph 3, Member States may provide that their regulatory authority or the Agency, as the case may be, shall submit, for the purposes of the formal decision, to the relevant body in the Member State its opinion on the request for an exemption. That opinion shall be published together with the decision.

8. The regulatory authority shall transmit to the Commission, without delay, a copy of every request for exemption as of its receipt. The decision shall be notified, without delay, by the competent authority to the Commission, together with all the relevant information with respect to the decision. That information may be submitted to the Commission in aggregate form, enabling the Commission to reach a well-founded decision. In particular, the information shall contain:

(a) the detailed reasons on the basis of which the regulatory authority, or Member State, granted or refused the exemption together with a reference to paragraph 1 including the relevant point or points of that paragraph on which such decision is based, including the financial information justifying the need for the exemption;

(b) the analysis undertaken of the effect on competition and the effective functioning of the internal market in natural gas resulting from the grant of the exemption;

(c) the reasons for the time period and the share of the total capacity of the gas infrastructure in question for which the exemption is granted;

(d) in case the exemption relates to an interconnector, the result of the consultation with the regulatory authorities concerned; and

(e) the contribution of the infrastructure to the diversification of gas supply.

9. Within a period of two months from the day following the receipt of a notification, the Commission may take a decision requiring the regulatory authority to amend or withdraw the decision to grant an exemption. That two-month period may be extended by an additional period of two months where further information is sought by the Commission. That additional period shall begin on the day following the receipt of the complete information. The initial two-month period may also be extended with the consent of both the Commission and the regulatory authority.

Where the requested information is not provided within the period set out in the request, the notification shall be deemed to be withdrawn unless, before the expiry of that period, either the period has been extended with the consent of both the Commission and the regulatory authority, or the regulatory authority, in a duly reasoned statement, has informed the Commission that it considers the notification to be complete.

The regulatory authority shall comply with the Commission decision to amend or withdraw the exemption decision within a period of one month and shall inform the Commission accordingly.

The Commission shall preserve the confidentiality of commercially sensitive information.

The Commission's approval of an exemption decision shall lose its effect two years from its adoption in the event that construction of the infrastructure has not yet started, and five years from its adoption in the event that the infrastructure has not become operational unless the Commission decides that any delay is due to major obstacles beyond control of the person to whom the exemption has been granted.

10. The Commission may adopt Guidelines for the application of the conditions laid down in paragraph 1 of this Article and to set out the procedure to be followed for the application of paragraphs 3, 6, 8 and 9 of this Article. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 51(3).

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